CONGRESS OF THE UNITED STATES
CONGRESSIONAL BUDGET OFFICE

FEBRUARY 1986

An Analysis of the President's Budgetary Proposals for Fiscal Year 1987

Prepared at the Request of the
Senate Committee on Appropriations

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J932-11

AN ANALYSIS OF THE PRESIDENT'S BUDGETARY PROPOSALS FOR FISCAL YEAR 1987

The Congress of the United States
Congressional Budget Office

NOTES

Unless otherwise indicated, all years referred to in this report are fiscal years.

Details in the text and tables of this report may not add to totals because of rounding.

The source of data concerning the President's budget is the Office of Management and Budget. The source of other data, unless otherwise noted, is the Congressional Budget Office.

The Balanced Budget and Emergency Deficit Control Act of 1985 is also referred to in this volume more briefly as the Balanced Budget Act.

PREFACE

This analysis of the President's budget for fiscal year 1987 was prepared at the request of the Senate Committee on Appropriations. The report discusses the President's policy proposals in terms of changes from the Congressional Budget Office (CBO) baseline budget projections for 1987-1991. It provides estimates of the budgetary impact of the Administration's proposals using CBO's economic assumptions and technical estimating methods.

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Director

February 1986

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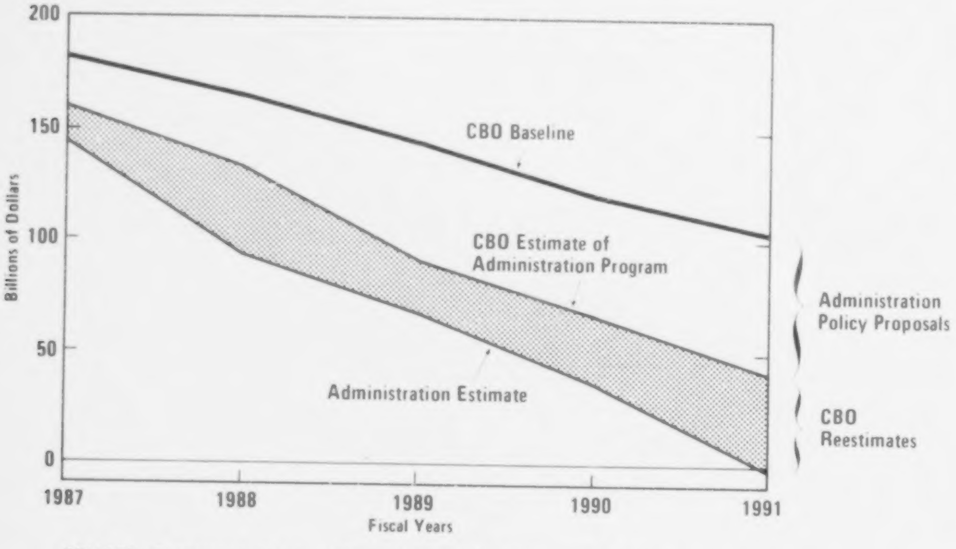
SUMMARY

The Congressional Budget Office (CBO) estimates that the federal government deficit under Administration policies would decline from $204.7 billion in 1986 to $159.7 billion in 1987 and $40.1 billion in 1991. The Administration's program would reduce total spending and the deficit substantially compared with CBO's baseline projections. Using CBO's economic assumptions and technical estimating methods, however, the resulting deficit exceeds the 1987 target in the Balanced Budget and Emergency Deficit Control Act of 1985 (Public Law 99-177) by $15.7 billion (see Summary Figure 1 and Summary Table 1).

Summary Figure 1.

Federal Deficit Projections[a]



SOURCE: Congressional Budget Office; Office of Management and Budget.

[a] Includes Social Security, which is off-budget.

CBO has reestimated the Administration's deficit figures for two main reasons. First, CBO assumes a lower rate of real economic growth and, until 1991, higher inflation-adjusted interest rates than does the Administration. (CBO and Administration economic assumptions are compared in Chapter I.) Second, based on the historical relation between appropriations and outlays, CBO estimates that spending for national defense will be significantly greater than shown in the President's budget.

THE ADMINISTRATION'S BUDGET PROGRAM

CBO's baseline projections provide a benchmark against which the Administration's budget program can be measured. The baseline generally assumes that defense and nondefense appropriations are held constant in real terms

SUMMARY TABLE 1. THE BUDGET OUTLOOK UNDER ADMINISTRATION POLICIES (By fiscal year, in billions of dollars) a/

	1986	1987	1988	1989	1990	1991
Revenues						
Administration Estimate	777.1	850.4	933.2	996.1	1,058.1	1,124.0
CBO Estimate	778.7	849.9	928.1	999.9	1,074.8	1,150.2
Outlays						
Administration Estimate	979.9	994.0	1,026.8	1,063.6	1,093.8	1,122.7
CBO Estimate	983.5	1,009.7	1,060.3	1,091.4	1,141.3	1,190.2
Deficit (-) or Surplus						
Administration Estimate	-202.8	-143.6	-93.6	-67.5	-35.8	1.3
CBO Estimate	-204.7	-159.7	-132.3	-91.4	-66.6	-40.1
Deficit Targets	b/	-144.0	-108.0	-72.0	-36.0	0

SOURCE: Congressional Budget Office; Office of Management and Budget.

a. Includes Social Security revenues and outlays, which are off-budget.

b. The Balanced Budget Act set a target of $171.9 billion in fiscal year 1986, but limited the sequestration to $11.7 billion.

and that tax and entitlement laws are continued unchanged. Under these assumptions, CBO projects that the federal deficit will fall from $208.3 billion in 1986 to $181.3 billion in 1987 and $104.3 billion in 1991. The baseline projections are described in more detail in CBO's recent annual report, The Economic and Budget Outlook: Fiscal Years 1987-1991.

As in recent years, the Administration proposes to increase defense spending above baseline levels and to reduce the deficit primarily through large cuts in domestic programs. Over the 1987-1991 period, the Administration's proposals would reduce the deficit by a total of $224.1 billion (see Summary Table 2).

SUMMARY TABLE 2. THE ADMINISTRATION'S DEFICIT REDUCTION PROGRAM AS ESTIMATED BY CBO (By fiscal year, in billions of dollars) a/

Major Program	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline Deficit	181.3	164.9	143.6	120.1	104.3	
Proposed Changes						
Revenues	-5.9	-7.1	-8.6	-7.2	-6.5	-35.4
Outlays						
National defense	12.7	20.2	25.1	29.6	32.9	120.6
Entitlements and other mandatory spending	-15.2	-20.3	-23.2	-26.7	-30.1	-115.5
Nondefense discretionary spending	-8.7	-16.0	-26.3	-32.7	-40.6	-124.3
Offsetting receipts	-4.1	-7.9	-14.8	-9.1	-9.2	-45.2
Net interest	-0.2	-1.7	-4.4	-7.4	-10.7	-24.4
Subtotal, outlays	-15.6	-25.6	-43.5	-46.3	-57.7	-188.7
Total Policy Changes	-21.6	-32.7	-52.1	-53.6	-64.2	-224.1
President's Budget as Estimated by CBO	159.7	132.3	91.4	66.6	40.1	
President's Budget	143.6	93.6	67.5	35.8	-1.3 b/	
CBO Reestimates	16.1	38.7	23.9	30.8	41.4	150.9

SOURCE: Congressional Budget Office; Office of Management and Budget.

a. Includes Social Security revenues and outlays, which are off-budget.

b. Surplus.

The Administration is proposing roughly 6 percent real growth in defense appropriations in 1987 and an annual average of about 3 percent real growth over the 1987-1991 period. This policy would increase defense spending by $120.6 billion above the baseline, which assumes no real growth in defense. To allow for this growth in defense and to reduce the deficit, the required cuts in nondefense spending and increase in revenues total $34.3 billion in 1987 and $344.7 billion over five years. They are to be achieved as follows:

- $35.4 billion in higher revenues. Of this amount, more than half--$19.4 billion--results from increased Internal Revenue Service (IRS) staff and other IRS initiatives. Extension of the cigarette tax increase of 8 cents per pack will generate $9.3 billion. Increasing the federal employee contribution to Civil Service Retirement from 7 percent to 9 percent of earnings will bring in an additional $5.6 billion.

- $115.5 billion in reductions in entitlement programs. The cuts are similar to last year's Administration proposals. The largest reductions--$45.6 billion--would be targeted on Medicare and Medicaid. General Revenue Sharing would be eliminated, thereby saving $22.5 billion. Federal employee retirement and health benefits would be cut by $17.7 billion, child nutrition and food stamps by $7.3 billion, and guaranteed student loans by $7.2 billion. No reductions are proposed in Social Security, unemployment compensation, or veterans benefits. Only small cuts would be made in means-tested, income transfer programs.

- $124.3 billion in lower nondefense discretionary spending. Among the largest proposed reductions are transportation programs ($17.4 billion), Farmers Home Administration direct loans ($15.2 billion), civilian agency pay raises ($13.4 billion), housing assistance ($14.5 billion), health research and education ($8.8 billion), training, employment, and social services ($8.4 billion), Pell Grants for needy college students ($8.2 billion), and elementary and secondary education ($6.8 billion). Increases are proposed for international affairs, science and space, and the Internal Revenue Service.

- $45.2 billion in increased offsetting receipts. About $18 billion would come from increases in premiums charged to participants in Supplementary Medical Insurance (Part B of Medicare). Over $12 billion would result from fees charged to users of government services, such as navigation and boating assistance, customs and meat inspection, park and forest recreation, and government-sponsored enterprises. (Some proposed user fees are included in revenues and in other spending categories.) The sale of five Power Marketing Associations and the Naval Petroleum Reserves would raise, net of forgone receipts, about $11 billion.

- $24.4 billion in reduced net interest costs would result from the other policy changes.

The Administration's proposed revenue and spending changes are described in detail and analyzed in Chapters II through IV of this report.

As in last year's budget, the Administration proposes to transfer certain federal activities to state and local governments and to reduce federal involvement in credit markets. Of the $309 billion in proposed nondefense outlay reductions, $92 billion--or 30 percent--would come from grants to state and local governments. Many grant programs are targeted for elimination, notably General Revenue Sharing ($22.5 billion in cuts) and grants for the construction of sewage treatment plants ($2.9 billion). Others would be subject to large reductions, including education, training, and social services ($17.0 billion), Medicaid ($10.0 billion), federal-aid highways ($5.5 billion), other transportation grants ($8.5 billion), and housing assistance ($8.1 billion). Under the Administration's proposals, federal grants would represent 1.7 percent of gross national product (GNP) in 1991, as compared with 2.7 percent of GNP in 1985 and 3.4 percent of GNP as recently as 1980.

The Administration proposes to cut federal direct lending over the next five years by one-quarter, or $44.6 billion. Eliminating Farmers Home Administration and Small Business Administration direct loans would account for $28 billion of this reduction. The volume of federally guaranteed loans would also be reduced by restricting eligibility and lowering the amount of subsidy. A more detailed overview of the Administration's credit proposals is given in Appendix A.

The proposed increases in defense and the cuts in nondefense programs would change the composition of federal spending as set forth in Summary Table 3 and Summary Figure 2. With 3 percent real growth, defense outlays would grow only slightly less rapidly than GNP. National defense spending would absorb 6.4 percent of GNP in 1987 and 6.2 percent in 1991. In the CBO baseline, which assumes no real defense growth, the 1991 defense share is only 5.7 percent of GNP.

The budget proposals would accelerate the projected decline in nondefense spending. Nondefense discretionary spending currently represents 4.1 percent of GNP, about the same level as it did 25 years ago. In the baseline it declines to 3.4 percent of GNP by 1991, and under the Administration program it would fall to 2.7 percent. Spending for Social

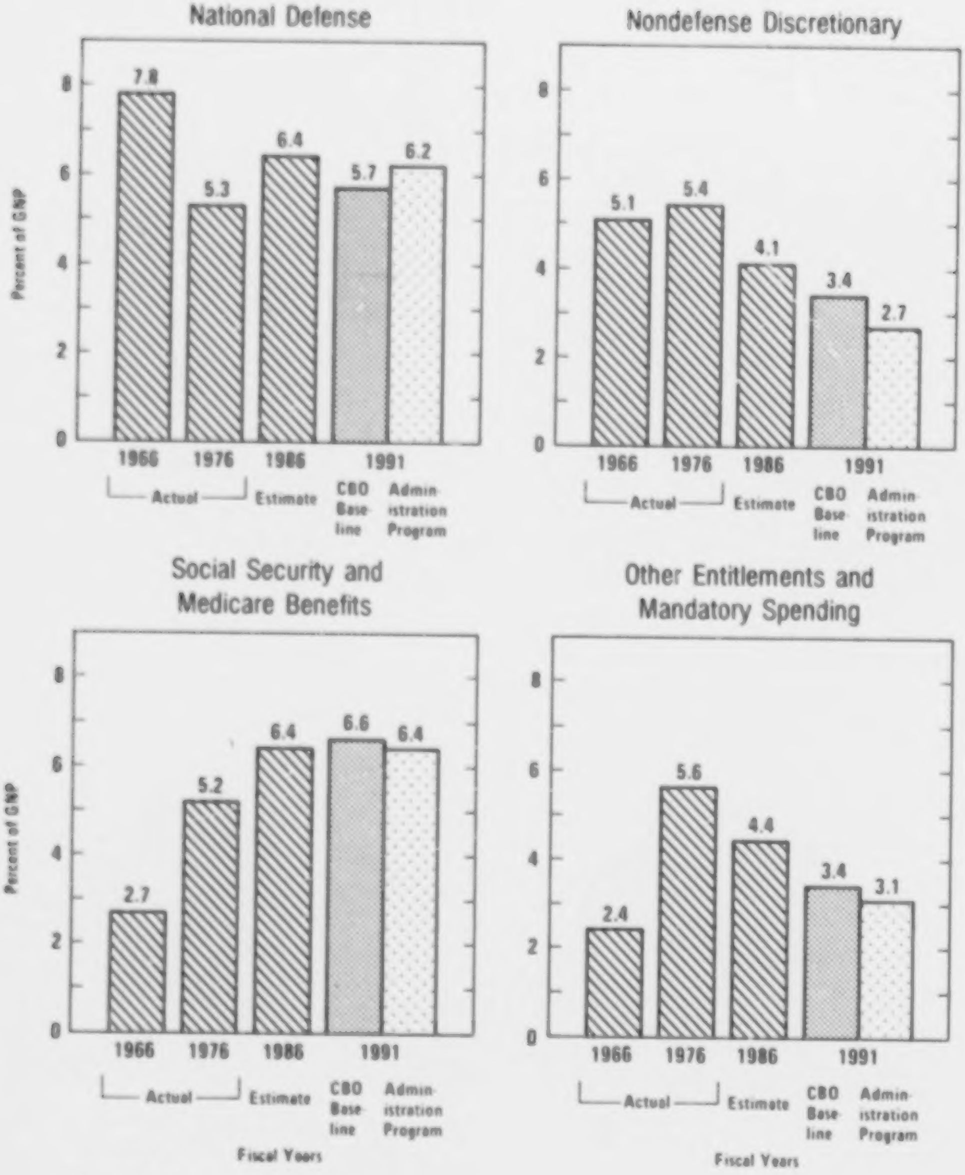
SUMMARY TABLE 3. CBO ESTIMATES OF THE ADMINISTRATION'S BUDGET PROGRAM (By fiscal year) a/

	1986	1987	1988	1989	1990	1991
			In Billions of Dollars			
National Defense	269.5	296.7	316.6	336.1	356.5	376.9
Entitlements and Other Mandatory Spending	452.7	458.3	488.7	513.2	539.8	573.9
Nondefense Discretionary	172.0	165.6	166.7	162.1	163.2	163.4
Net Interest	139.8	144.7	152.7	153.2	151.7	149.6
Offsetting Receipts	-50.5	-55.6	-64.3	-73.3	-69.9	-73.6
Total Outlays	983.5	1,009.7	1,060.3	1,091.4	1,141.3	1,190.2
Revenues	778.7	849.9	928.1	999.9	1,074.8	1,150.2
Deficit	204.7	159.7	132.3	91.4	66.6	40.1
Debt Held by the Public	1,716.6	1,875.3	2,006.6	2,097.0	2,162.6	2,201.7
			As a Percent of GNP			
National Defense	6.4	6.6	6.5	6.4	6.3	6.2
Entitlements and Other Mandatory Spending	10.8	10.2	10.1	9.8	9.6	9.5
Nondefense Discretionary	4.1	3.7	3.4	3.1	2.9	2.7
Net Interest	3.3	3.2	3.2	2.9	2.7	2.5
Offsetting Receipts	-1.2	-1.2	-1.3	-1.4	-1.2	-1.2
Total Outlays	23.5	22.4	21.9	20.9	20.3	19.7
Revenues	18.6	18.9	19.2	19.2	19.1	19.0
Deficit	4.9	3.5	2.7	1.8	1.2	0.7
Debt Held by the Public	41.0	41.6	41.5	40.2	38.5	36.4
Memorandum: GNP	4,192	4,504	4,838	5,214	5,619	6,047

a. Includes Social Security revenues and outlays, which are off-budget. On-and off-budget totals are shown in Summary Table 5.

Summary Figure 2.

The Composition of Federal Spending



SOURCE: Congressional Budget Office.

Security and Medicare benefits is projected to rise slightly in the baseline relative to GNP but remains constant under Administration policy. Other entitlements and mandatory spending are projected to decline from their current level of 4.4 percent of GNP, but the drop is greater with the budget proposals.

CBO BUDGET ESTIMATES

For purposes of comparability with the CBO baseline projections and with other deficit reduction plans, the foregoing estimates of the Administration's budget use CBO baseline economic and technical estimating assumptions. As indicated earlier, however, CBO's estimates of the deficit are somewhat higher than those of the Administration.

Summary Table 4 shows the CBO reestimates of the Administration's budget. The CBO reestimates add $16.1 billion to the projected deficit in 1987, $38.7 billion in 1988, and $41.4 billion in 1991. In 1987 and 1988, technical differences between CBO and the Administration predominate. Differences in economic assumptions are more important thereafter. The reestimates of revenues and spending are detailed in Appendixes B and C, respectively.

CBO's economic assumptions reduce the estimated deficit slightly in 1986 and 1987, but they add to the deficit estimates by increasing amounts thereafter. In 1991, CBO's estimate of the deficit is $24.4 billion higher than that of the Administration because of differing economic assumptions. CBO's economic assumptions add to both revenues and outlays as a result of higher rates of inflation than the Administration assumes. Because CBO assumes lower real growth and higher real interest rates than the Administration, however, the addition to outlays is greater than the addition to revenues.

CBO's real growth projection is based on average economic growth for nine-year periods following recession troughs. On average, since World War II, the annual growth rate of real over such nine-year periods has been 3.7 percent, and the CBO projection closely approximates that result. The Administration's projection for real growth is not much higher for any one year and is well within the range of historical experience. By 1991, however, the level of real gross national product assumed by the Administration is about 2½ percent higher than in CBO's projection.

Both the Administration and CBO assume a decline in nominal and real (inflation-adjusted) interest rates over the 1987-1991 period. By 1991, both assume a Treasury bill rate between one and two percentage points above inflation—about equal to the average over the past 30 years. But the CBO assumptions envision real interest rates declining gradually to this level, while the Administration assumes that inflation-adjusted rates return much more quickly to their historical averages.

Technical estimating differences between CBO and the Administration add an average of $18 billion per year to the projected deficits. Of this amount, about $14 billion per year involves national defense. Each year the Congress appropriates new budget authority, which allows the Department of Defense to enter into spending obligations. But these obligations may not result in cash outlays for some years. CBO uses historical spending rates to estimate the amount of outlays that will occur each fiscal year from given levels of budget authority. The Administration, however, believes that historical defense spending patterns will not apply in the future.

SUMMARY TABLE 4. CBO REESTIMATES OF THE ADMINISTRATION'S BUDGETARY PROPOSALS (By fiscal year, in billions of dollars) a/

	1986	1987	1988	1989	1990	1991
Deficit President's Budget	202.8	143.6	93.6	67.5	35.8	-1.3 b/
CBO Reestimates						
Economic						
Revenues	2.2	-1.7	-4.2	1.2	11.1	21.9
Outlays	-1.3	-2.3	3.8	14.5	28.6	46.3
Deficit	-3.5	-0.6	8.0	13.3	17.5	24.4
Technical						
Revenues	-0.6	1.2	-0.9	2.7	5.5	4.2
Outlays	4.8	17.9	29.8	13.3	18.9	21.2
Deficit	5.4	16.7	30.7	10.6	13.3	17.0
Total Reestimates	1.9	16.1	38.7	23.9	30.8	41.4
Deficit, President's Budget as Estimated by CBO	204.7	159.7	132.3	91.4	66.6	40.1

SOURCE: Congressional Budget Office.

a. Includes Social Security revenues and outlays, which are off-budget. On-and off-budget totals are shown in Summary Table 5.

b. Surplus.

Other technical estimating differences, in total, increase both estimated revenues and outlays. On the revenue side, the major difference between CBO and the Administration concerns the proposed limitation on pay raises for federal civilian employees. CBO assumes that this proposal has no net effect on revenues, while the Administration assumes a $7 billion revenue loss. Most of the remaining differences on the outlay side result from the higher net interest costs necessitated by other technical reestimates to revenues and outlays. These additional debt service costs add $20 billion over the 1987-1991 period. CBO and the Administration also differ in their estimates of farm price supports, Outer Continental Shelf escrow releases, and the proceeds from sale of the Naval Petroleum Reserves and Power Marketing Administrations.

SUMMARY TABLE 5. CBO ESTIMATES OF ON-BUDGET AND OFF-BUDGET SPENDING AND REVENUES IN THE ADMINISTRATION'S PROGRAM (By fiscal year, in billions of dollars)

	1986	1987	1988	1989	1990	1991
Revenues						
On-budget	580	636	687	738	788	839
Off-budget (OASDI)	198	214	241	262	287	311
Total	779	850	928	1,000	1,075	1,150
Outlays						
On-budget	799	811	850	870	907	941
Off-budget (OASDI)	184	198	210	222	235	249
Total	983	1,010	1,060	1,091	1,141	1,190
Deficit (-) or Surplus						
On-budget	-219	-175	-163	-132	-119	-102
Off-budget (OASDI)	14	15	31	40	52	62
Total	-205	-160	-132	-91	-67	-40

SOURCE: Congressional Budget Office.

ON-AND OFF-BUDGET SPENDING AND REVENUES

The total outlays and revenues of the federal government includes both on-budget and off-budget activities. The Balanced Budget Act returned all previously off-budget entities to the budget, but moved off-budget the Social Security trust funds--Old-Age, Survivors, and Disability Insurance (OASDI). On-budget and off-budget activities must be added together, however, to determine the total federal deficit that must be financed by borrowing from the public. The estimated total deficit is also used in calculating the excess deficit amount for purposes of the Balanced Budget Act.

This volume focuses on total federal government fiscal activities because of their significance for the economy and for implementing the Balanced Budget Act. Moreover, distinguishing between on-and off-budget items would add significant complexity to the summary tables and thereby obscure the basic analytical story. Nevertheless, it is important to note that Social Security represents roughly 20 percent of outlays and 25 percent of revenues (see Summary Table 5). Also, in contrast to the on-budget activities, the Social Security trust funds are running growing surpluses. The Administration's fiscal year 1987 proposals include a modest speedup in the deposit of Social Security tax payments by state and local governments and a reduction in Social Security administrative costs, but no changes in benefit levels.

CHAPTER I

THE ADMINISTRATION'S ECONOMIC ASSUMPTIONS

Economic projections play an important role in budget estimates. Assumptions about the rate of economic growth and the rate of inflation have a substantial effect on projected tax receipts and on the growth of certain entitlement programs such as Unemployment Insurance. With the rapid growth of federal debt in recent years, interest-rate projections also have a major impact on projected budget outlays.

This chapter briefly compares the Administration's economic projections with those of the Congressional Budget Office (CBO), and discusses the Administration's proposed fiscal policy. The CBO economic projections are used in later chapters in reestimating the Administration's 1987 budget proposals.

THE SHORT-RUN OUTLOOK

While economic growth was sluggish last year, conditions appear to be favorable for a resumption of somewhat stronger growth this year. The slowdown last year was associated with a large reduction in inventory investment and a further deterioration of the trade balance. But the inventory adjustment appears to be largely over, and since the first quarter of last year the dollar has been on a substantial decline. Over the second half of the year, particularly in the last quarter, long-term interest rates fell sharply; during that same quarter, the stock market surged. Finally, early this year oil prices dropped precipitously. For these reasons, there is a fairly wide consensus among forecasters that the near-term economic outlook is quite favorable.

CBO's short-run economic forecast for 1986 and 1987 and that of the Administration are conditional on several specific assumptions regarding policy and such key factors as dollar exchange rates and oil prices. The CBO forecast is based on these assumptions:

- The budget deficit targets of the Balanced Budget and Emergency Deficit Control Act of 1985 (Public Law 99-177) are assumed to

TABLE I-1. COMPARISON OF ADMINISTRATION AND CBO SHORT-RUN ECONOMIC FORECASTS (By calendar year)

Economic Variable	Actual 1985	Forecast 1986	Forecast 1987
Fourth Quarter to Fourth Quarter (Percent change)			
Real GNP			
Administration	2.5	4.0	4.0
CBO	2.5	3.6	3.0
Nominal GNP			
Administration	5.8	8.0	8.3
CBO	5.8	7.6	7.2
Consumer Price Index a/			
Administration	3.2	3.7	4.1
CBO	3.2	3.5	4.5
Calendar year Average (Percent)			
3-Month Treasury Bill Rate			
Administration	7.5	7.3	6.5
CBO	7.5	6.8	6.7
10-Year Government Bond Rate			
Administration	10.6	8.9	8.5
CBO	10.6	9.0	8.9
Civilian Unemployment Rate			
Administration b/	7.2	6.7	6.5
CBO	7.2	6.7	6.7

SOURCE: Congressional Budget Office.

a. Urban wage and clerical workers.

b. The Administration's projection is for the total labor force including armed forces residing in the United States, while CBO's is for the civilian labor force excluding armed forces. In recent years, the former has tended to be 0.1 to 0.2 percentage points below the rate for the civilian labor force alone.

be fully implemented. The budget deficit is estimated at $208.3 billion in fiscal year 1986, and for fiscal year 1987 is assumed to be at the target of $144 billion.

- With respect to monetary policy, the behavior of the monetary aggregates is assumed to be within the ranges announced by the Federal Reserve on February 19.
- Food prices are expected to increase less than the general price level.
- The international value of the dollar is assumed to continue to decline, though less rapidly than in the last three months.
- The price (refiners' acquisition cost) of imported oil is assumed to fall about 18 percent between the last quarter of 1985 and mid-1986. 1/

In general, the assumptions underlying the Administration's forecast appear to be similar to CBO's. Both forecasts were prepared before the recent drop in oil prices. Spot prices are currently well below the oil price assumed in CBO's and the Administration's forecasts. The Administration's forecast assumes the fiscal policy contained in its 1987 budget, with large reductions in the federal deficit of roughly the magnitude assumed by CBO.

Both CBO and the Administration expect good economic performance in 1986 and 1987, with the Administration's forecast showing somewhat stronger economic growth than CBO's (see Table I-1). According to CBO's forecast, growth picks up from the sluggish 2.5 percent rate during 1985 (fourth quarter to fourth quarter) to 3.6 percent during 1986 and then slows moderately to 3.0 percent during 1987. 2/ The Administration's forecast

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1. For a detailed discussion of the current economic outlook and CBO's forecast, see Congressional Budget Office, The Economic and Budget Outlook: Fiscal Years 1987-1991 (February 1986), pp. 1-58.

2. Neither the Administration's nor CBO's forecast reflects the recent GNP revisions for the fourth quarter of 1985. After the revisions, real growth during 1985 (fourth quarter to fourth quarter) was 2.3 percent rather than 2.5. If the same level of GNP is assumed for 1986, this would raise growth to 4.0 percent in the CBO forecast.

shows growth of 4.0 percent during both years. Thus, the difference in growth forecasts for 1987 is one percentage point, a magnitude that is of consequence for budget estimates but well within the usual range of economic forecast errors. As this report is being written, the consensus for real growth among private forecasters is very slightly below CBO's estimates. The plunge in oil prices early this year has, however, caused many private forecasters to begin raising their growth forecasts. If lower oil prices prevail, the consensus forecast of growth could eventually turn out to be stronger than projected by CBO.

Both the CBO and Administration forecasts show slightly higher inflation in 1986 and 1987 than in 1985. In 1987, CBO has inflation slightly higher than the Administration. The Administration's forecast for short-term interest rates is 0.5 percentage point higher in 1986 than CBO's, but slightly lower in 1987. The temporary rise in short rates in the Administration's forecast stems in part from its forecast of relatively strong growth. Long-term rates, as measured by the 10-year government bond rate, decline moderately in the Administration's 1987 forecast, but remain essentially flat in the CBO forecast. The forecasts for unemployment are virtually the same.

The CBO's and the Administration's forecasts contain a considerable measure of uncertainty. Two major factors contributing to the uncertainty are oil prices and the value of the dollar—both of which have shown large movements in recent months. Lower oil prices and a cheaper dollar both tend to raise real growth. But while lower oil prices would help to reduce the rate of inflation, a cheaper dollar would tend to raise it.

MEDIUM-TERM PROJECTIONS

Neither CBO nor the Administration attempts to forecast the economy beyond the end of 1987. In making their projections for 1988 through 1991 (shown in Table I-2), both organizations rely on simple rules of thumb based on historical experience.

CBO's projection is based on average economic growth for nine-year periods following recession troughs. On average, since World War II, the annual growth rate of real GNP over such nine-year periods has been 3.7 percent; and the CBO projection closely approximates that result. In addition, CBO's projection shows inflation, measured by the Consumer Price Index, remaining relatively flat over the 1988-1991 period. Nominal and real interest rates are both assumed to decline over the period, reflecting the impact of lower deficits under current law. By 1991, real interest rates

TABLE I-2. COMPARISON OF ADMINISTRATION AND CBO ECONOMIC ASSUMPTIONS, 1986-1991 (By calendar year)

Economic Variable	Actual 1985	1986	1987	1988	1989	1990	1991
Nominal GNP (billions of current dollars)							
Administration	3,993	4,274	4,629	4,995	5,359	5,709	6,036
CBO	3,993	4,269	4,583	4,930	5,313	5,725	6,152
Real GNP (percent change, year over year)							
Administration	2.3	3.4	4.0	4.0	3.9	3.6	3.5
CBO	2.3	3.2	3.1	3.3	3.5	3.5	3.2
Consumer Price Index a/ (percent change, year over year)							
Administration	3.5	3.5	4.1	3.7	3.3	2.8	2.1
CBO	3.5	3.4	4.2	4.4	4.4	4.3	4.3
GNP Deflator (percent change, year over year)							
Administration	3.3	3.5	4.2	3.7	3.3	2.8	2.1
CBO	3.3	3.6	4.1	4.1	4.1	4.1	4.1
Three-Month Treasury Bill Rate (percent)							
Administration	7.5	7.3	6.5	5.6	4.8	4.3	4.0
CBO	7.5	6.8	6.7	6.4	6.1	5.7	5.4
Ten-Year Government Bond Rate (percent)							
Administation	10.6	8.9	8.5	7.3	5.5	4.8	4.5
CBO	10.6	9.0	8.9	8.2	7.5	6.8	6.1
Civilian Unemployment Rate (percent)							
Administration b/	7.2	6.7	6.5	6.3	6.1	5.8	5.6
CBO	7.2	6.7	6.7	6.5	6.3	6.1	6.0

SOURCE: Congressional Budget Office

a. Urban wage and clerical workers.

b. The Administration's projection is for the total labor force. See footnote b of Table I-1.

in CBO's projection are about equal to the average real rates over the last 30 years.

The Administration's medium-term projections differ somewhat from CBO's in regard to real growth, inflation, and interest rates; the differences are smaller for unemployment and nominal GNP. The Administration's medium-term projections for economic growth appear to be based on a projection of hours worked from the end of 1985 to the end of 1991, and an assumption that the growth in output per hour will approximate the average growth rate in the 1948-1981 period. 3/ Its projection for real growth is not much higher than CBO's for any one year. By 1991, however, the level of real GNP is about 2½ percent higher than in CBO's projection. The economic expansion envisioned in the Administration's projection would be above average for the period since World War II, but well within the range of historical experience. It is, for example, within CBO's "high growth path" projection—based on the pattern of the strongest nine-year expansion of the postwar period, which occurred after the recession of 1957-1958. 4/

The Administration's projection shows inflation trending downward during the 1988-1991 period, reflecting the assumption that monetary policy will tend to reduce growth rates for money aggregates. CBO's flat rate of inflation implicitly assumes that labor markets start to tighten when the unemployment rate nears 6.0 percent. The Administration clearly assumes that this does not occur until unemployment is somewhat lower. By 1991, the increase in the Consumer Price Index under the Administration's projection is about half the increase shown in the CBO projection, or 2.1 percent versus 4.3 percent (see Table I-2). By 1991, the CPI is roughly 5 percent higher with CBO's projection than with the Administration's.

Consistent with the projected decline in inflation, the Administration's projection shows interest rates falling considerably more than does CBO's: by 1991, the three-month Treasury Bill rate averages 4.0 percent and the ten-year government bond rate averages 4.5 percent. Adjusted for inflation, however, the Administration's real interest rates end up approximately the same as CBO's, although CBO's projections imply that the real rates decline more gradually.

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3. See Economic Report of the President (February 1986), pp. 67-69.

4. See Congressional Budget Office, The Economic and Budget Outlook: Fiscal Years 1987-1991 (February 1986), pp. 8-10.

The Administration's projection of nominal GNP is above CBO's during 1986-1989, but the difference reverses in 1990-1991. Nonetheless, the Administration projects a lower taxable share of GNP, which tends to reduce the Administration's budget receipts relative to CBO's. 5/ The differences in the unemployment projections are relatively small. By 1991, the Administration unemployment projection, on a comparable basis, is only a few tenths of a percentage point below CBO's.

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5. For further discussion of revenues, see Chapter II.

CHAPTER II

THE ADMINISTRATION'S REVENUE PROPOSALS

The Administration's budget program contains relatively modest revenue increases above those that would result from current law. Relative to CBO baseline projections, the President's revenue proposals would increase total revenues--including off-budget Social Security revenues--by $6 billion in 1987, $9 billion in 1989, and $7 billion in 1991. CBO's estimates of total revenues including the President's proposals are close to the Administration's--virtually the same as the Administration's estimate in 1987, $5 billion below in 1988, and $4 billion above in 1989. After 1988, CBO's reestimates add revenues in each year. In 1991, CBO's estimate is $26 billion--about 2 percent--above the Administration's. Almost all of the CBO reestimates derive from the use of somewhat different economic assumptions.

ESTIMATED REVENUE LEVELS

CBO estimates revenues under the Administration's program (including off-budget revenues) at $850 billion in 1987, $928 billion in 1988, and $1,150 billion in 1991 (see Table II-1). Administration revenues are projected to grow slightly faster than GNP in 1986-1988, reaching 19.2 percent of GNP in 1988, and more slowly than GNP thereafter, claiming 19.0 percent of GNP in 1991.

CBO projects lower real growth and higher inflation throughout the projection period than does the Administration. While differences between projected real growth rates are significant, differences between projected inflation rates are larger. The net result is that CBO's projected nominal GNP path rises from $65 billion below the Administration's GNP in 1988 to $116 billion above the Administration's GNP in 1991. (For a discussion of CBO's economic projections, see Chapter I.) Federal revenues roughly follow nominal income because over 90 percent of revenues come from income and payroll taxes. Therefore, the differences in nominal GNP paths

TABLE II-1. ADMINISTRATION AND CBO ESTIMATES OF ADMINISTRATION'S PROGRAM REVENUES BY SOURCE (By fiscal year, in billions of dollars)

Revenue Source	1986	1987	1988	1989	1990	1991
Administration Estimates						
Individual Income Taxes	353.7	386.0	425.9	455.5	482.0	516.3
Corporate Income Taxes	70.9	86.7	101.2	111.8	119.7	125.6
Social Insurance Taxes and Contributions	280.4	302.8	335.0	358.1	384.1	407.7
On-budget	82.5	88.5	92.1	94.5	97.9	102.3
Off-budget a/	197.9	214.3	242.8	263.7	286.1	305.4
Excise Taxes						
Windfall profit taxes	4.1	2.8	1.9	1.5	1.3	1.0
Other	30.5	32.4	31.6	31.2	31.9	32.6
Other	37.5	39.7	37.7	38.0	39.1	40.8
Total Revenues	777.1	850.4	933.2	996.1	1,058.1	1,124.0
Percent of GNP	18.5	18.7	19.0	18.9	18.8	18.9
CBO Estimates						
Individual Income Taxes	354.2	385.0	422.0	460.8	500.3	542.7
Corporate Income Taxes	72.2	89.4	101.2	109.7	114.1	116.0
Social Insurance Taxes and Contributions	280.8	302.3	333.5	357.7	386.8	415.8
On-budget	82.5	88.7	92.6	95.6	100.0	104.6
Off-budget a/	198.3	213.7	240.9	262.1	286.8	311.3
Excise Taxes						
Windfall profit taxes	4.2	2.0	1.6	1.6	1.5	1.4
Other	30.3	32.3	31.4	31.1	31.7	32.5
Other	37.1	38.9	38.2	39.0	40.4	41.6
Total Revenues	778.7	849.9	928.1	999.9	1,074.8	1,150.2
Percent of GNP	18.6	18.9	19.2	19.2	19.1	19.0

SOURCES: Budget of the United States Government for Fiscal Year 1987 and Congressional Budget Office.

a. Off-budget revenues consist of Federal Old-Age and Survivors Insurance Trust Fund and Disability Insurance Trust Fund (OASDI) revenues.

work to reduce CBO's estimates of Administration program revenues below the Administration's estimates in 1987 through 1989 and to raise them above the Administration's in 1990 through 1991 (see Table II-2).

Another major economic assumption affecting revenue projections is the share of GNP that will take the form of taxable income, both individual and corporate. CBO projects this share as being higher than does the Administration. This assumption works to raise CBO's estimated revenues above the Administration's in each year (see Table II-2). It mostly offsets the effect of the difference in nominal GNP paths in 1987 through 1989, and reinforces the effect in 1990-1991. Because the government receives tax

TABLE II-2. CBO'S REESTIMATES OF ADMINISTRATION'S PROGRAM REVENUES (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991
Revenues as Estimated by Administration a/	850	933	996	1,058	1,124
Reestimates Caused by Differences in Assumptions About:					
Nominal GNP path	-8	-9	-8	1	18
Income shares	6	7	8	8	11
Timing adjustments b/	3	-4	3	6	-5
Proposals	-1	1	1	2	2
Total Reestimates	c/	-5	4	17	26
Revenues as Estimated by CBO a/	850	928	1,000	1,075	1,150

a. Unless otherwise noted, aggregate program revenues include payroll tax receipts of the Federal Old-Age and Survivors Insurance Trust Fund and Disability Insurance Trust Fund (OASDI), which are off-budget.

b. Including some technical adjustments.

c. Negative reestimate of less than $500 million.

payments with various lags after incomes are earned, the full budgetary effects of income growth usually take two years to play out. The net result of these assumptions is to leave CBO's estimates of the Administration's program revenues close to the Administration's estimates in 1987 through 1989 and above the Administration's in 1990-1991.

Several Administration program proposals were reestimated by CBO. Only two reestimates are significant. CBO assumes that the federal government will not receive the $1 billion in petroleum overcharge restitution funds budgeted in 1987. CBO does not follow the Administration's practice of assuming a reduction in aggregate wages as a result of proposed reductions in federal civilian employee pay raises and, therefore, the CBO estimate of the revenue effect of this proposal is zero. CBO's baseline economic and technical estimating assumptions are described in more detail in Appendix B.

PROPOSED LEGISLATION AND ADMINISTRATIVE ACTION

CBO estimates that the President's legislative and administrative proposals would add $36 billion to revenues between 1986 and 1991 (see Table II-3). Half of the legislative proposals are repeats from last year--as is the major administrative proposal, an increase in Internal Revenue Service staffing. User fees and trust fund reforms account for about 10 percent of net proposed revenue increases, with user fee increases of $1 billion. Other proposals for an additional $12 billion in user fees are included on the spending side of the budget as offsetting receipts and collections.

Education tax incentive proposals (education savings accounts and tuition tax credits) would reduce income taxes by roughly $6 billion during 1987-1991. Over half of proposed revenue increases would result from Internal Revenue Service (IRS) initiatives, such as increased enforcement made possible by additional IRS examiners, more automation, and more return-checking. Another 40 percent of increased revenues would come from excise tax and fee increases. The extension of the higher cigarette tax enacted in 1982 in the Tax Equity and Fiscal Responsibility Act (TEFRA) would provide about two-thirds of this increase. A two-percentage-point increase in employee contributions to Civil Service Retirement would provide another $6 billion, or 15 percent, of new revenues. Descriptions of these proposals follow.

TABLE II-3. CBO ESTIMATES OF REVENUE EFFECTS OF PRESIDENT'S LEGISLATIVE AND ADMINISTATIVE PROPOSALS, BY MAJOR TYPE

(By fiscal year, in billions of dollars)

	1986	1987	1988	1989	1990	1991	Cumulative 1986-1991 Changes
CBO Baseline a/	777.8	844.0	921.0	991.3	1,067.5	1,143.6	
Proposed Changes							
Education tax incentives	---	-0.4	-0.8	-1.2	-1.5	-1.7	-5.6
IRS initiatives b/	c/	2.2	3.3	4.5	4.4	4.9	19.4
Excise taxes and fees (net)	0.9	2.7	2.8	2.8	2.8	2.7	14.7
Civil Service Retirement and Railroad Industry taxes	---	1.1	1.6	1.5	1.5	1.5	7.2
Other							
Acceleration of state and local deposits of payroll taxes	---	0.4	0.3	1.2	0.1	-0.9	1.1
All other	---	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
Total	0.9	5.9	7.1	8.6	7.2	6.5	36.3
President's Budget as Estimated by CBO	778.7	849.9	928.1	999.9	1,074.8	1,150.2	

a. Revenues under current law, including extensions of Superfund, Airport and Airway, and Highway Trust Fund taxes at rates in effect upon expiration of these taxes in September 1985, December 1987, and September 1988, respectively. Baseline also includes off-budget OASDI revenues.

b. Mostly tax collection gains from proposed Internal Revenue Service expenditures.

c. Revenue gain of less than $50 million.

TABLE II-4. CBO ESTIMATES OF REVENUE EFFECTS OF ADMINISTRATION'S PROPOSED EDUCATION TAX INCENTIVES (By fiscal year, in billions of dollars)

Proposal	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
Education Savings Accounts	a/	-0.2	-0.3	-0.6	-0.7	-1.8
Tuition Tax Credits	-0.4	-0.6	-0.9	-0.9	-0.9	-3.8
Total	-0.4	-0.8	-1.2	-1.5	-1.7	-5.6

a. Revenue loss of less than $50 million.

Education Savings Accounts

Under the education savings account proposal, parents could set up an account to fund post-secondary education for each dependent child under 18 years of age, and contribute up to $1,000 per year to the account. Interest earnings would be tax-free. The $1,000 maximum contribution would decline for parents with adjusted gross incomes (AGI) above $40,000, reaching zero for those with AGIs above $60,000. The accounts could be spent on tuition and room and board for full-time students in degree programs. For part-time students, expenditures would be restricted to tuition.

The revenue loss from these accounts would be small initially, but would grow as amounts deposited cumulated, reaching $700 million in 1991 (see Table II-4). Revenue losses would continue to increase after 1991 and could reach $2 billion in 1996.

Several bills permitting education savings accounts have been introduced in the 98th and 99th Congresses, although none has been voted out of committee. These bills differ from the Administration's proposal in that contributions would be deductible from the parents' AGI and, in most bills, the accumulated value of an account would be included in the child's AGI after college. Initial-year revenue losses are much higher when deposits are deductible, but the difference narrows over time because the account ultimately is included in the AGI of the child.

Tuition Tax Credits

The President's proposed tax credit for elementary and secondary school tuition would be capped at $300 or 50 percent of tuition costs up to $600. Like the education savings accounts, this proposal was also included in the President's last three budgets. During a two-year transition period, the proposed credit would rise from $100 to $200 and then stay at $300 per dependent. The maximum would be phased downward for taxpayers with AGIs above $40,000. Taxpayers with AGIs of $60,000 or more would not be eligible for the credit. The credit would not be refundable. The estimated revenue loss from the credit would level off at roughly $900 million per year when it was fully phased in.

One bill to establish a tuition tax credit has been introduced in the 99th Congress (H.R. 96). A number of tuition credit bills were introduced in the 98th Congress. One of these, S. 528, similar to this proposal, was reported out of the Senate Committee on Finance but did not come to a floor vote.

If enacted, the tax credit would constitute a relatively large share of total general-purpose federal aid proposed in the budget for elementary, secondary, and vocational education, providing about $4 billion in tuition subsidies over the 1987-1991 period (see Table II-4). Currently, the major source of untargeted federal aid is the Chapter II block grant, with proposed budget authority of $500 million for 1987. Most of the remaining $6.7 billion in aid proposed for elementary, secondary, and vocational education is targeted on children or districts with special needs, on districts with federal installations, or on particular services such as science education.

Internal Revenue Service Initiatives

Of the $19.4 billion in increased revenues resulting from proposed IRS initiatives, over half are attributed to increases in IRS staff (see Table II-5). The Administration proposes to increase the permanent IRS examination staff by 2,500 positions each year over the 1987 to 1989 period (for a total increase of 7,500 positions), with some advance hiring taking place during 1986. About three-quarters of the additional personnel would be examiners. Other new personnel would provide direct and indirect support to the examiners. Also proposed is the purchase of about 9,000 portable computers

TABLE II-5. CBO ESTIMATES OF REVENUE EFFECTS OF ADMINISTRATION'S PROPOSED INTERNAL REVENUE SERVICE INITIATIVES
(By fiscal year, in billions of dollars)

Proposal	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
Examination Staff Increases	0.6	1.5	2.6	2.8	2.9	10.4
Increased Automation of Examination System	0.3	0.8	1.2	1.3	1.5	5.1
Increased Follow-Up of Information Returns	0.2	0.2	0.2	0.2	0.2	1.0
Charges for Collection Costs	0.3	0.4	0.4	0.4	0.4	1.8
All Other	0.7	0.4	0.2	-0.2	a/	1.1
Total	2.2	3.3	4.5	4.4	4.9	19.4

a. Revenue loss of less than $50 million.

for use by auditors, along with additional desktop personal computers and related computer hardware. The increased automation would bring in an estimated $5 billion in collections over 1987-1991. Another proposal would increase the follow-up of discrepancies between information returns supplied by third parties (such as W-2 and 1099 forms) and taxpayer returns.

In addition, the Administration proposes to replace existing penalties for overdue taxes with charges calibrated to cover the total cost of collecting the money, and to establish user charges for IRS letters of determination and private letter rulings. Letters of determination are requested primarily by employee benefit plans and tax-exempt organizations. Private letter rulings are clarifications of IRS positions in particular cases, such as those involving changes in accounting periods or methods. The implementation of the fees for letters and rulings will require legislation. Taken together, they would generate about $30 million in revenues per year.

The Administration program contains roughly $1.6 billion in IRS spending over 1986-1991 to fund these initiatives. Most of these funds are earmarked for new hiring. The increased collections are also predicated upon a 1986 supplemental appropriation for IRS of $340 million.

Excise Taxes and Fees

As mentioned above, the principal revenue raiser among the excise tax proposals is the extension of the 16-cents-per-pack tax on cigarettes, scheduled under current law to drop to 8 cents per pack on March 15, 1986. The maintenance of the 16-cents-per-pack rate would generate about $9 billion in net revenues over 1986-1991 (see Table II-6).

TABLE II-6. CBO ESTIMATES OF REVENUE EFFECTS OF ADMINISTRATION'S PROPOSED EXCISE TAXES AND FEES (By fiscal year, in billions of dollars)

Proposal	1986	1987	1988	1989	1990	1991	Cumulative 1986-1991 Changes
Extension of Cigarette Tax Increase (net)	0.8	1.7	1.7	1.7	1.7	1.7	9.3
Black Lung Fee Increase (net)	---	0.2	0.2	0.2	0.2	0.3	1.1
Superfund Tax Increase (net) a/	0.1	0.5	0.4	0.4	0.4	0.4	2.3
Elimination of Highway Excise Tax Exemptions (net)	---	0.2	0.2	0.2	0.2	0.2	1.0
Nuclear Regulatory Commission User Fees	---	0.2	0.2	0.2	0.2	0.2	0.8
All Other	---	b/	b/	0.1	0.1	0.1	0.3
Total	0.9	2.7	2.8	2.8	2.8	2.7	14.7

a. Increases in Superfund revenues above those that would be generated under an extension of the tax rates in effect at the end of September 1985, when Superfund taxing authority expired.

b. Revenue increase of less than $50 million.

The proposed Black Lung Disability and Superfund tax increases included in this year's budget appeared in last year's budget as well. The Administration proposes to increase the Black Lung Disability Trust Fund tax on coal production from $1.00 to $1.50 per ton for underground mining and from $0.50 to $0.75 per ton for surface mining. These were last adjusted by the Black Lung Revenue Act of 1981 (Public Law 97-119), which raised the taxes from $0.50 to $1.00 per ton for underground mining and from $0.25 to $0.50 per ton for surface mining. The proposed fee increases are sought to help offset trust fund debt, which is increasing by more than $400 million per year. The higher fees are estimated to raise total revenues by about $1 billion over the 1987-1991 period.

The Administration proposes to reauthorize and expand the taxing authority under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, which expired at the end of fiscal year 1985, leaving the proposed mix of taxes unspecified. These taxes finance the clean-up of waste sites by the Hazardous Substance Response Trust Fund, or Superfund. The Administration proposes to provide the fund with about $5 billion in revenues over the 1986-1991 period. This is about $3 billion above the CBO baseline estimate of Superfund revenues generated under an extension of the tax rates in effect in September 1985. The $5 billion in Superfund receipts would meet the Administration's proposed spending for waste removal over the period. This level of funding would provide $3.6 billion in total budget revenues over 1986-1991 (measured as total Superfund receipts less resulting income tax offsets).

The Administration proposes repeal of the present gasohol and alcohol exemptions from federal gasoline and diesel fuel excise taxes. It also proposes repeal of the exemptions from tire, gasoline, and diesel fuel taxes available to bus operators. CBO's estimate of the 1987-1991 revenue gain from repeal of the exemptions is $1.0 billion. This estimate assumes a coordinated phasing-out of the existing alternative alcohol fuels tax credit, which is not specified in the Administration's proposal. The revenue gain would be lower if the credit were to remain in place. The budget proposals also include several new user fees, including fees for services performed by the Nuclear Regulatory Commission and the Federal Emergency Management Agency.

Civil Service Retirement (CSR) and Railroad Taxes

The Administration proposes to increase the CSR contribution rate for most federal civilian employees from 7 percent to 9 percent of pay, effective January 1, 1987. Variants of this proposal were included in the Administration's 1984 and 1985 budgets. CBO estimates that this increase would bring an additional $5.6 billion in revenues (see Table II-7). The Administration also proposes to reduce federal civilian pay increases below average private-sector wage growth projected for the 1987-1991 period. This can be done at the President's discretion, unless the Congress passes legislation overruling the decision. CBO estimates that this proposal would have no effect on total revenues.

The Administration is proposing that the rail industry finance a larger portion of rail pension benefits, reducing the federal government subsidy, and that these benefits be taxed under the general rules for private-sector pension benefits. Taken together, the two proposals would increase revenues by about $150 million per year. In addition, the Administration is proposing for the third year to extend unemployment insurance (UI) coverage to the rail industry--at present, the only sector not covered under the insurance system. If brought into the system, the rail industry UI contributions would come to $100-$150 million per year. The Administration is also

TABLE II-7. CBO ESTIMATES OF REVENUE EFFECTS OF ADMINISTRATION'S PROPOSED CIVIL SERVICE RETIREMENT AND RAILROAD INDUSTRY TAXES
(By fiscal year, in billions of dollars)

Proposal	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
Increase in CSR Employee Contribution	0.9	1.2	1.2	1.2	1.1	5.6
Railroad Industry Tax Increases	0.2	0.3	0.3	0.3	0.2	1.3
Increase in D.C. Government Retirement Contribution	a/	a/	0.1	0.1	0.1	0.3
Total	1.1	1.6	1.5	1.5	1.5	7.2

a. Revenue gain of less than $50 million.

proposing, for the third year, to increase the District of Columbia employer contribution to CSR to the level needed to cover the full cost of the retirement program. Higher D.C. government employee contributions and reduced program benefits are also proposed.

Other Proposals

The budget includes two other significant budgeted revenue increases, from the acceleration of state and local government deposits of payroll taxes and from petroleum overcharge restitution fund receipts. CBO estimates that the acceleration of deposits would bring $2 billion in revenues forward into 1987-1990, resulting in a reduction in 1991 revenues of about $900 million (see Table II-3). This year's proposal, in contrast to the proposal in last year's budget, would move state and local governments to the faster schedule in stepwise fashion over two years to give them time to adjust to the change. A similar proposal, discussed this year in the Senate, met some opposition from state and local governments.

CBO assumes that the Administration's estimated $1 billion in federal government collections from the petroleum overcharge restitution fund during 1987 will not materialize because of a recent Supreme Court decision that requires apportionment of these funds to state governments by early March 1986--too soon for passage of legislation mandating a federal government share in the apportionment.

CBO estimates that the President's remaining budget proposals would have, at most, minor effects on revenues. Additional detail on CBO's estimates of Administration revenues is contained in Appendix B.

CHAPTER III

THE ADMINISTRATION'S DEFENSE BUDGET

The President's budget for fiscal year 1987 proposes 3 percent real growth in national defense over the 1987-1991 period--the same real program level that was contained in the 1986 Congressional budget resolution. That resolution assumed zero real growth for defense in 1986. Congress actually provided less than zero real growth in defense appropriations in 1986, and the Balanced Budget Act sequestration for 1986 reduced the program level further--to 3 percent below the previous year in real terms.

The Administration's budget requests $320 billion in budget authority for the national defense function in 1987, an increase of $33 billion over the post-sequestration level for 1986 and $19 billion over the CBO baseline. Over the 1987-1991 period, the budget would exceed the CBO baseline--which assumes zero real growth in defense appropriations--by $163 billion. In terms of real growth, the measurement depends on whether year-to-year changes in new budget authority alone is considered, or whether the focus is on year-to-year changes in program levels. On the basis of actual 1986 budget authority after sequestration--about $286.8 billion--and an inflation rate of about 3.4 percent, the President's request for 1987 new budget authority reflects about 8 percent real growth. In order to pay for certain 1986 military personnel costs, however, the Congress made unobligated balances available in lieu of new budget authority. This has the effect of raising the real program level in 1986 by about $5 billion above what it would be under new budget authority. If the higher program level is used as the base, then the President's request contains about 6 percent real growth in 1987. Real growth averages about 3 percent annually over the five-year period.

The largest defense funding increases proposed in the President's budget are in the readiness accounts, especially operation and maintenance (O&M). In 1987, real growth is concentrated in O&M and research and development, and procurement declines in real terms. From 1988 through 1991, O&M would continue to experience greater relative real growth; however, unlike 1987 procurement would grow faster than research and development during the out-years.

CBO estimates that outlays for the national defense function under Administration proposals would be significantly higher than the estimates contained in the President's budget--$68 billion higher over the next five-years. In 1987 alone, the CBO estimate is higher by $14.5 billion. Most of the differences in outlay estimating are concentrated in the operation and maintenance, procurement, and research and development accounts. Estimating defense outlays is difficult because appropriations for different activities are spent over varying periods and can be affected by many factors. In the past, both CBO and the Administration have employed historical spending patterns to estimate outlays from given levels of budget authority. This year, CBO continues this approach while the Administration believes that various factors--such as slower progress payments to contractors--will alter the historical patterns. In CBO's view, most of these factors have been taken into account in its spending rate assumptions (see box).

DEFENSE FUNDING LEVELS

The Administration's budget request of $320 billion in budget authority for the national defense function in 1987 represents an increase of $33 billion over the post-sequestration level for 1986 and $19 billion over the CBO baseline as noted above. These increases translate into 6 percent real growth in 1987 and an annual average of about 3 percent real growth over the 1987-1991 period (see Table III-1).

The real growth in budget authority would continue the trend of annual real increases since 1980 (with the exception of 1986 in which year the defense budget declined about 3 percent in real terms). The real decline in 1986 came after a 9 percent average annual real growth in the previous five years.

The request for 1987 contains a slight shift in the composition of budget authority. From 1980 through 1986, the budget became more heavily weighted towards investment, with the procurement accounts growing the most--from about 24 percent to almost 32 percent of the defense budget. All but two major categories of accounts (military personnel and research, development, testing and evaluation--RDT&E) showed real declines in 1986, but procurement is the only major category that would decline in real terms in 1987. Operation and maintenance (O&M) and RDT&E receive by far the largest increases. The request for O&M exceeds the CBO baseline by $9.0 billion and the RDT&E request is $7.5 billion over the baseline. Procurement's share of the request falls from 32 percent of the defense budget to about 30 percent in 1987, while the shares for O&M and RDT&E

DEFENSE BUDGET ESTIMATES

The CBO and Administration estimates for the defense budget differ in two basic ways. First, CBO and the Administration use different concepts for defining the defense baseline. The Administration's defense baseline, or current services projections, for 1987 and 1988 are the same as those of the 1986 Congressional budget resolution. For 1989 through 1991, the estimates reflect the budget resolution policy of 3 percent annual real growth in budget authority. The CBO defense baseline, on the other hand, assumes no real growth in program level throughout the five-year projection period. The two different defense baselines are as follows:

(in billions of dollars)

	1987	1988	1989	1990	1991
CBO Baseline					
Budget Authority	300.9	314.7	329.5	345.0	361.5
Outlays	284.0	296.4	310.9	326.9	343.9
Administration Current Services					
Budget Authority	323.4	346.8	371.5	397.2	423.5
Outlays	284.9	303.7	328.6	354.1	379.4

The second major difference in the defense budget estimates results from the use of different technical methods for estimating the outlays that would result from the Administration's budget proposals. As explained more fully in this chapter and in Appendix C, CBO uses historical spending rates to estimate outlays that will occur each fiscal year from given levels of budget authority provided in appropriation bills. The Administration also uses the same methodology, but believes that historical spending patterns will not hold for the future. The different outlay estimates for the Administration's 1987-1990 defense budget authority proposals are shown below (in billions of dollars).

(in billions of dollars)

	1987	1988	1989	1990	1991
Outlays Resulting from Administration Budget Authority Proposals					
CBO	296.7	316.6	336.1	356.5	376.9
Administration	282.2	299.1	322.3	344.8	366.3

TABLE III-1. MAJOR SPENDING CHANGES PROPOSED IN ADMINISTRATION'S 1987 BUDGET FOR FUNCTION 050: NATIONAL DEFENSE (By fiscal year, in billions of dollars)

Changes	1987	1988	1989	1990	1991	Five-Year Totals
			Budget Authority			
CBO Baseline	300.9	314.7	329.5	345.0	361.5	1,651.6
Proposed Changes						
Military personnel	1.5	2.3	2.5	2.7	2.6	11.5
Operation & maintenance	9.0	12.0	16.3	20.8	22.1	80.2
Procurement	-0.9	1.7	7.2	9.7	12.3	29.9
RDT&E a/	7.5	6.5	4.4	3.6	6.9	28.9
Military construction	1.3	3.4	3.1	4.3	3.9	15.9
Other-DoD	0.2	-0.2	-1.4	-2.9	-5.0	-9.4
Subtotal	18.5	25.6	32.2	38.1	42.6	157.1
Other defense	0.8	1.0	1.2	1.2	1.2	5.4
Total Changes	19.4	26.6	33.4	39.3	43.8	162.5
President's 1987 Budget as Reestimated by CBO	320.2	341.3	362.9	384.3	405.3	1,814.0
			Outlays			
CBO Baseline	284.0	296.4	310.9	326.9	343.9	1,562.1
Proposed Changes						
Military personnel	1.2	2.2	2.4	2.6	2.5	11.0
Operation & maintenance	6.4	10.6	14.5	18.7	20.8	71.0
Procurement	1.2	1.3	2.5	4.1	5.2	14.3
RDT&E a/	3.5	5.9	5.1	4.1	5.6	24.2
Military construction	0.1	0.9	1.9	2.7	3.5	9.1
Other-DoD	0.2	-0.9	-1.9	-3.3	-5.3	-11.2
Subtotal	12.6	19.9	24.6	29.0	32.3	118.4
Other Defense	0.1	0.3	0.5	0.6	0.7	2.2
Total Changes	12.7	20.2	25.1	29.6	32.9	120.6
President's 1987 Budget as Reestimated by CBO	296.7	316.6	336.1	356.5	376.9	1,682.8

SOURCE: Congressional Budget Office.

a. Research, development, test, and evaluation.

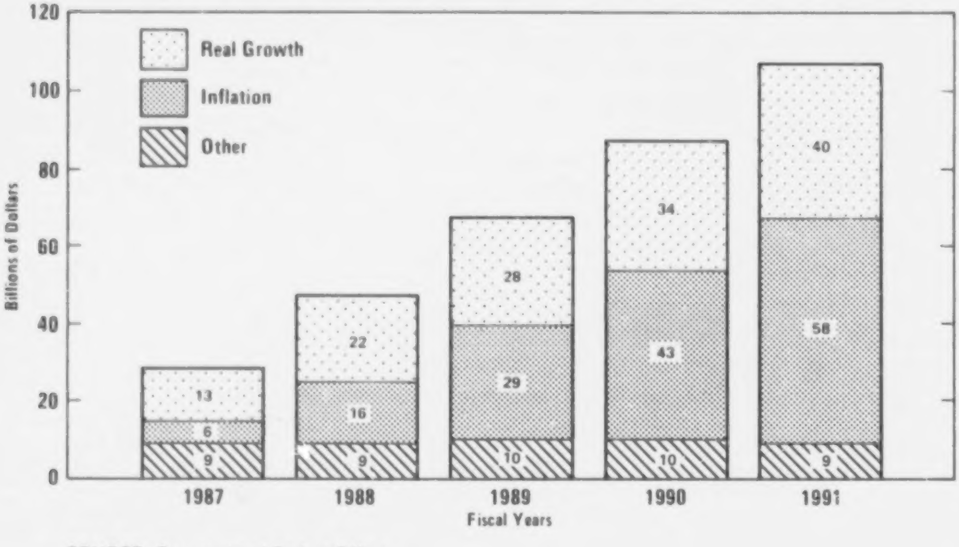
rise slightly from 26 percent to 27 percent and from 11.6 percent to 13.1 percent, respectively.

The relative shares continue to change after 1987. By 1991, RDT&E's share of budget authority returns to its 1986 value--about 11.5 percent. Procurement's share rises to about 31 percent and O&M's share is one percentage point higher than 1987 at 28 percent. As Table III-1 shows, all major accounts would experience real growth after 1987, so the change in relative shares reflects differences in the rates of growth rather than actual reductions in some accounts and increases in others. (The only reductions from the CBO baseline after 1987 occur because of lower pay raise assumptions in the Administration's budget.) (See box on inflation.)

Outlays under the Administration's budget, as estimated by CBO, increase $27 billion in 1987 over the level estimated for 1986 and exceed CBO baseline projections by $13 billion, as shown in Table III-1. Compared with 1986 outlays--estimated to be about $269.5 billion--outlays would grow by about $9 billion as the result of past increases in budget authority (and assuming that budget authority in 1987 was held at the 1986 post-sequestration level). Covering the costs of inflation would add about $6 billion. The final $13 billion of outlay growth estimated for 1987 would stem from the real growth in budget authority. These differences are shown in Figure III-1.

Figure III-1.

Sources of Outlay Growth in Defense Outlays, Fiscal Years 1987-1991



SOURCE: Congressional Budget Office.

INFLATION AND REAL GROWTH IN THE DEFENSE BUDGET

The annual defense budget request is for new budget authority and includes funds to cover anticipated inflation. The budget authority represents the right to enter into contracts to buy goods and services. Since these contracts--in particular those for major weapons such as ships, tanks, and aircraft--can extend over several years, budget authority to fund the estimated costs of inflation must also extend over the life of each contract. Thus, a substantial part of the DoD budget request represents future price changes.

Both CBO and the Administration base their estimates for defense price changes on their overall economic forecasts. The Administration uses deflators for pay, fuel, and other purchases. In recent years, the Administration has used a special deflator for major commodities that assumed 30 percent faster price growth for them than for the general economy, but the 1987 budget excludes this premium. The following table shows CBO and Administration outlay estimates for all defense purchases less compensation. The differences are very close to the differences between CBO and Administration estimates of the GNP deflator (see Chapter I).

COMPARISON OF CBO AND ADMINISTRATION INFLATION ASSUMPTIONS FOR DEFENSE PURCHASES

(Percent change, purchase deflator for outlays)

	1986	1987	1988	1989	1990	1991
CBO	3.1	3.1	3.8	4.1	4.1	4.1
Administration	2.7	3.8	3.7	3.3	2.9	2.3

Pay raises pose a unique problem in that they are treated as administered price changes. Real growth in military personnel is determined by increases in strengths; in the short term, pay raises do not affect strength and quality appreciably and are a suitable proxy for price changes. In the long run, differences in pay between federal and private employees can make a difference in measuring real growth because quantity and quality have time to change.

Concern about aggregate real growth focuses on defense budget authority, however, and requires use of budget authority deflators rather than outlay deflators. (The latter are more relevant for comparisons with other price indexes.) Budget authority deflators are a weighted average of outlay deflators reflecting price changes over the period when funds are spent. Using the Administration's pay assumptions and the individual forecasts of CBO and the Administration for other defense purchases, real growth in budget authority averages about 3 percent from 1987 through 1991.

Measuring real growth in 1987 depends on whether the year-to-year change in new budget authority is considered or whether the focus is on year-to-year changes in program levels. On the basis of actual 1986 budget authority after sequestration--about $286.8 billion--the President's request for 1987 new budget authority reflects about 8 percent real growth. In order to pay for certain 1986 military personnel costs however, the Congress made unobligated balances available in lieu of new budget authority. This raised the real program level in 1986 by about $5 billion above what it would be under new budget authority. If the higher program level is used as the base, then the President's 1987 budget authority request represents about 6 percent real growth.

The future pattern of outlay growth under the Administration's budget proposals shows that the largest growth is attributable to meeting the costs of inflation. Over the five years, outlays would grow by $336 billion over the 1986 level. About 45 percent of the increase, or about $152 billion, would result from expected price growth. Another 40 percent, or $137 billion, would represent real growth in budget authority and the remaining 15 percent, or $47 billion, would stem from past increases in budget authority.

DEFENSE OUTLAY ESTIMATES

Using the Administration's budget authority request and historical spendout rates, CBO estimates that outlays for the national defense function will be significantly higher than the estimates contained in the President's budget. Table III-2 shows that the CBO estimates for some program areas are lower than the Administration's, but that higher estimates for operation and maintenance, procurement, and research and development dominate the net result. The estimating differences follow the same pattern in the out-years, with the major discrepancies concentrated in the same three categories. The net difference rises from $14.5 billion in 1986 to $17.5 billion in 1988 and then declines gradually to $10.6 billion in 1991, which is still a very large estimating difference by historical standards.

Comparison with Past Estimating Differences

CBO and the Administration have never had estimating differences of this magnitude before. The 1986 difference--$14.5 billion--is more than double the greatest difference that occurred before this year in terms of current dollars; after accounting for program growth, the difference between the two estimates is only 50 percent greater. Table III-3 shows that before 1986 the CBO and Administration "budget year" estimates usually have been very close and that CBO's estimate is as likely to be lower as higher than the Administration's; the two estimates varied widely--by $6.5 billion--only for the Administration's first (1982) budget.[1] Table III-3 shows 30 data points for estimating differences for the 1982-1986 budget requests. Only two are greater than $10 billion and they are two to four years after the budget year. For budget year 1987, all but the current year estimates (five of six) are greater than $10 billion.

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[1] The term budget year refers to the upcoming fiscal year budget. The term current year refers to the fiscal year in progress.

Relevance of Historical Outlay Rates

In the past, both CBO and the Administration have employed historical outlay rates to estimate outlays from given budget authority. The Administration published its outlay rates based on past spending patterns in the Defense Department's Financial Summary Tables. This year, CBO continues this approach while the Administration is deviating from it. Using the Administration's historical outlay rates for O&M, procurement, and RDT&E, CBO computed outlays $14.3 billion higher than the President's budget estimates for 1987 and $61.6 billion higher for the 1987-1991 period. CBO's own estimates for these accounts are also $14.3 billion higher for 1987 and $64.2 billion higher for the five years. If first-year outlay rates and outlay

TABLE III-2. CBO OUTLAY REESTIMATES OF PRESIDENT'S 1987 REQUEST FOR FUNCTION 050: NATIONAL DEFENSE (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991
President's Budget	282.2	299.1	322.3	344.8	366.3
Reestimates					
Military personnel	-0.2	-0.1	-0.1	-0.1	-0.1
O&M	0.7	6.3	5.8	4.6	4.2
Procurement	9.6	8.1	6.1	6.1	4.2
RDT&E	4.1	2.6	1.3	0.1	0.7
Military construction	0.6	0.7	0.8	0.9	1.0
Family housing	0.5	0.4	0.5	0.6	0.5
Revolving funds	-0.6	-0.3	-0.3	-0.1	0.5
Pay raises	-0.2	-0.2	-0.3	-0.3	-0.4
Other	-0.1	-0.1	-0.1	-0.1	-0.1
Subtotal	14.5	17.5	13.8	11.7	10.6
President's Budget as Reestimated by CBO	296.7	316.6	336.1	356.5	376.9

SOURCE: Congressional Budget Office.

rates and outlays from prior year appropriations used by the Administration in its 1986 budget request are employed, a similar analysis shows 1987 outlays in the three major accounts to be $15.1 billion higher than the budget estimates.

In short, there is little disagreement between CBO and the Administration over outlays levels under historical spending patterns or outlay rates. Outlay estimating, nevertheless, is an imprecise process that uses both historical data and analytical judgments. In the past few years, defense outlays have been underestimated as well as overestimated by varying amounts. For example, applying both CBO and Administration spending rate assumptions to the levels of budget authority provided in previous years, estimated outlays are within 2 percent to 4 percent of actual outlays for the 1980-1985 period for the operations and maintenance, procurement, and research and development categories. (See details in Appendix C.) In contrast, the estimating differences between CBO and the Administration for these categories for the 1987-1991 period range from 4 percent to 8 percent per year, or double the historical experience.

TABLE III-3. DIFFERENCES IN OUTLAY ESTIMATES OF PRESIDENT'S 1987 BUDGET REQUEST (CBO'S ESTIMATES LESS ADMINISTRATION'S ESTIMATES) (By fiscal year, in billions of dollars)

Budget Year	Current Year	Budget Year (BY)	BY+1	BY+2	BY+3	BY+4
1982	0.7	6.5	4.7	11.4	-0.6	a/
1983	3.3	1.8	1.8	2.0	3.7	9.3
1984	-0.5	-0.6	-3.0	-1.5	3.3	4.2
1985	-2.9	1.5	4.7	3.9	7.7	10.2
1986	-1.2	-1.3	-1.9	0.1	4.2	6.1
1987	3.7	14.5	17.5	13.8	11.7	10.6

SOURCE: Congressional Budget Office

a. Less than $500 million.

Other Factors Affecting Outlays

The Administration's outlay estimates for 1987 reflect the levels contained in the Congressional budget resolution of last August, as adjusted for new pay and inflation assumptions. It should be noted, however, that the budget resolution targets for defense programs were derived from Senate budget authority figures and the House outlay estimates, with no program detail. The Senate-passed resolution had an outlay target for 1987 that was $7 billion higher than the final resolution--an amount equal to about half of the CBO and Administration estimating difference. Also, the Senate resolution anticipated a much slower spending program than the Administration is proposing. The Senate resolution assumed the greatest increases in procurement outlays which spend out slowly while the Administration proposes increases in the fast spending categories of operation and maintenance and RDT&E. Thus, program composition can account for much of the remaining estimation difference between the CBO and Administration outlay estimates for 1987.

The Administration also justifies its budget estimates on the basis of policy changes and other considerations that it believes will result in slower spending than that implied by historical outlay rates. The main policy changes that, in its judgement, slow outlays are:

- Reduced progress payments to defense contractors--a policy decision that went into effect during fiscal year 1985.
- Suspensions of contractors and the introduction of tougher audits to reduce costs.
- The large amount of funding-about $24 billion--being withheld from obligation because of uncertainty over its availability; these funds are associated with the 1986 sequestration, potential transfers, and limits on appropriations in excess of authorizations.
- Uncertainty and hesitation on the part of contracting and finance officers who do not know the ultimate availability of funding as the result of possible future sequestrations.

CBO believes that these factors will affect outlays by only a small amount, if at all. What impact they might have should be temporary and would not affect outlays beyond a few months. For example, the Department of Defense (DoD) decided to slow progress payments during fiscal year

1985; any impact, however, would be limited to 1986 and 1987 because outlay savings in later years would be offset mostly by payments that were withheld earlier. In other words, this policy affects only the timing of outlays and, over time, the savings vanish. Similarly, the outlay effects of temporary suspensions of contractors would affect only timing of outlays and would be small in the long run .

Withholding funds does not affect outlay rates per se; rather it affects the base against which the outlay rates are multiplied. CBO's estimates reflect the outlay savings from the 1986 sequestration, the transfers to military personnel, and other factors leading to ultimate expenditures 2 percent to 3 percent less than the full appropriations.

If these policies and considerations were going to affect outlays, their effect should already be observed. Since last July, however, defense outlays have speeded up and have been 14 percent above previous year levels. This rate of spending is expected to slow considerably during the next few months as a result of the 1986 appropriation and sequestration actions, but CBO does not expect it to slow down as much as implied by the Administration's estimates. In CBO's view, the policy and other factors that the Administration assumes will slow spending will have little or no additional effect on spending rates; those that do have impact are reflected in CBO's estimates as well. CBO believes that historical spending patterns are still relevant and should continue to be used for outlay estimates.

Finally, the Administration has argued that it can manage its outlays to achieve its budget estimates. CBO believes this would be possible, though difficult. A fundamental difficulty centers on the decentralized nature of the defense finance and accounting system. Managing outlays would require an intricate set of controls and procedures that do not exist now and would take some time to develop.

Another difficulty stems from the fact that about a third of all defense outlays result from prior-year appropriations and contract commitments. Controlling these outlays would be difficult because, as contractors make deliveries, they expect to be paid. In those instances where delays are legally possible, they may induce contractors to raise future contract bids, thereby raising the cost of procurement.

Finally, one way to manage outlays is to slow obligations, yet this avenue has certain problems that stem from conflicting objectives of keeping outlays down and, at the same time, using appropriations to serve their purpose of improving national defense. Further, the ability to slow obligations is constrained by time limits on the availability of funding after which unobligated funds lapse or are no longer available. To the extent that obligations were slowed, inefficiencies and cost growth might result, making the slowdown undesirable even if it were possible.

MAJOR DEFENSE PROPOSALS

The defense budget serves the national security objectives of the United States by supporting a variety of land, air, and naval forces. Under the Administration's budget, most major force categories would increase in 1987--especially the strategic forces in which the number of bomber aircraft would increase about 10 percent and the number of sea-based intercontinental ballistic missiles would increase about 6.5 percent. In addition to greater numbers, forces would be modernized; for example, M-60 tanks now in the Army's inventory would be replaced with M-1 tanks. Also, increases in manpower might make some units more effective even though the number of units was unchanged.

Table III-4 examines the proposed funding for the defense force structure in terms of the appropriation categories used by the Congress. The categories of military personnel and O&M fund the operations and readiness of currently deployed forces. Military personnel pays for those people on active and reserve duty and O&M finances a wide range of logistical and personnel support functions. The procurement accounts contribute to force operations and readiness with funding for spare parts.

Table III-4 presents the sources of the 6 percent real growth proposed by the Administration. For example, it shows that the military personnel account would grow in real terms in 1987 by 2 percent--the same rate of increase as in 1986, but a slightly lower rate than annual increases from 1980 through 1985. O&M, on the other hand, would recover from the real decline in 1986 by growing at a rate of about 12 percent--a rate much higher than the average rate of about 6 percent achieved for the 1980-1985 period. Though not shown in the table, funding for procurement of spare and repair parts would decline about 1 percent in real terms between 1986 and 1987; these funds fell about 20 percent in real terms between 1985 and 1986, but they had grown in real terms by an annual average rate of about 24 percent for the 1980-1985 period.

The force growth projected for 1987 results from past decisions to procure ships, aircraft, and vehicles. The improvements in quality of weapons results from past decisions to pursue technological initiatives with RDT&E funding. These accounts grew rapidly from 1980 through 1985 and,

TABLE III-4. REAL GROWTH IN DEFENSE BUDGET AUTHORITY, BY APPROPRIATION CATEGORIES (By fiscal year, in billions of dollars and percent change)

		Real Growth			
				1986-1987	
Category	1987 Request (Dollars)	1980-85 Average (Percent)	1985-1986 (Percent)	Percent	Dollars
Military Personnel	76.8	3	2	2	1.5
Operation and Maintenance	86.3	6	-6	12	9.0
Procurement	95.9	15	-2	-1	-0.9
RDT&E	42.0	12	7	22	7.5
Military Construction	6.8	14	-7	24	1.3
Family Housing	3.4	8	-5	17	0.5
Other-DoD	0.3	a/	a/	a/	-0.4
Subtotal-DoD	311.5	9	-3	6	18.5
Other Defense	8.7	14	-4	9	0.8
Total, National Defense	320.2	9	-3	6	19.4

SOURCE: Compiled by Congressional Budget Office based on data supplied by the Department of Defense.

a. Because this category includes offsetting receipts and other miscellaneous accounts, real growth in percentage terms is misleading.

while procurement suffered a real decline in 1986, RDT&E grew about 7 percent in real terms. Similarly, procurement would decline in real terms in 1987 by about 1 percent and RDT&E would grow about 22 percent.

The following sections of this chapter discuss the composition of the Administration's defense budget in more detail, starting with the readiness accounts--military personnel and O&M--and concluding with the investment accounts--procurement and RDT&E.

Military Personnel

The military personnel appropriation funds the pay and allowances of members of active and reserve forces. The Administration has requested $6.5 billion more in 1987 than was appropriated in 1986 for this account, the 1987 figure, however is only $1.5 billion more than the CBO baseline--for a total of $74.2 billion. The request calls for increasing both active and reserve (including the National Guard) strengths by 2.0 percent, or 65,000 people, by the end of 1987; this is the same rate of increase as the 1980-1985 average. Also, the request would raise certain components of military pay and allowances.

Table III-5 shows the average percent growth in strength levels for three periods: from 1980 through 1985, from 1985 to 1986, and from 1986 to 1987. Since 1980, active end strength--that is, the number at the end of the fiscal year--has increased by an average of 20,000 people, or 1.0 percent, per year. The growth in 1987 would be less--14,000 people, or 0.6 percent. Of the four services, the Army has had the smallest amount of growth over the 1980-1985 period. In 1987 the Army requests only 100 more active service personnel; however, as discussed below, Army Reserve components are growing. The largest active force growth would occur in the Navy, with the goal of manning a larger fleet. Of the 11,400 additional personnel requested by the Navy, 10,000 would be assigned to new ships and squadrons. The Marine Corps has requested the second largest growth in active service personnel as it continues to improve readiness, mobility, and fire power, highlighted by the addition of a target acquisition battery to its artillery forces. The Air Force increase would be relatively small, providing for new and revised force structure and modernization.

The 1987 request would raise end strengths in the reserve components by 51,263, or 4.5 percent, over 1986; this is slightly lower than the average increase since 1980. Army Reserve and National Guard strengths would increase by a combined 29,000 people (or 3.8 percent), mainly for combat support and combat service support. This increase would enable the Army

Reserve to reach its goal for 1987 of having 90 percent of its perceived requirement and allow the National Guard to build toward its 1991 strength goal of 492,100 people. Of the 29,000 additional people, 6,400 would be full-time personnel. The Navy Reserve would grow by 13,547, mainly for increased manning of Naval Reserve ships and for greater tactical, mobility, and support activities. The Marine Corps Reserve would grow by 1,381 people who would assume additional duties and missions. The Air Force Reserve and Air National Guard would increase by 7,441 people, mainly to support increased force structure and modernization.

CBO estimates the cost of the strength increases at $330 million for active forces and $570 million for the reserves. The Administration also is requesting $2.9 billion for retired pay accrual and $1.9 billion for the cost of

TABLE III-5. INCREASES MILITARY STRENGTH LEVELS (By fiscal year, in thousands of people at year end and percents)

Service Branch	1987 Request	Percent Increase 1980-1985 Average	1985-1986	1986-1987
Army	781	a/	a/	a/
Navy	593	1.6	1.9	2.0
Marine Corps	200	1.0	0.4	0.8
Air Force	607	1.5	0.8	0.1
Subtotal	2,181	1.0	0.8	0.6
Reserves	1,186	4.8	4.3	4.5
Total	3,367	2.2	1.9	2.0

SOURCE: Compiled by Congressional Budget Office from data supplied by the Department of Defense.

a. Less than 0.5 percent.

the pay raise in calendar year 1986, neither of which were funded in 1986 with new budget authority because unobligated balances from procurement and RDT&E were made available instead.

Other significant increases include $80 million for permanent change of station allowances, $70 million for enlisted subsistence, and $170 million for reenlistment bonuses. The budget contains an allowance--$2.6 billion--in addition to the requested budget authority, for a 4 percent military pay raise effective October 1, 1986. The CBO baseline assumes a 3.3 percent military pay raise.

Operation and Maintenance

The O&M accounts fund a wide range of activities--some directly related to force operations, such as training exercises, weapons maintenance, supplies, and other general logistical support. O&M also funds personnel support activities--such as training of individual members (apart from training in units), medical care, and military base or community services--which are only indirectly related to force readiness. Overall, O&M has a much higher rate of real growth--about 12 percent--in 1987 than the 6 percent average from 1980 through 1985, allowing some recovery from the 6 percent real decline experienced in 1986. As shown in Table III-6, all individual activities of the O&M account follow the overall pattern of real growth, except airlift and sealift--the program for moving forces over long distances.

In dollar terms, the largest real growth--about $2 billion--would go to general purpose forces. These include active duty conventional forces--army divisions, aircraft carrier battle groups, and tactical air wings--along with theater nuclear forces like Pershing missile batteries. In contrast, strategic forces embrace intercontinental nuclear forces such as the Minuteman and MX missiles, the Trident submarine and missiles, B-52 and B-1 bombers, and other support forces. Strategic forces would grow by about $1.0 billion in real terms under the President's budget. The increases in these two major force programs would fund about 200,000 hours of flying time for Army and Air Force units; support additional forces, like a new Trident submarine and several B-1 aircraft; and pay for force modernization, for example, the M-1 tank and the Apache attack helicopter.

Reserve force funding would grow by over 10 percent in 1987. These forces would receive the additional money for training and weapons support. Flying time for aviation units and time at sea for the naval reserve both would increase. Backlogs in clothing and equipment supplies would be reduced by the budget request. Intelligence and communications programs would experience real growth of about 20 percent in 1987. These funds would be used to improve integration of strategic communications and to improve overall communications reliability.

The remaining activities funded in the O&M account serve centralized support functions. Central supply and maintenance activities include major overhauls of weapons which would receive much of the real growth in this

TABLE III-6. REAL GROWTH IN OPERATION AND MAINTENANCE
(By fiscal year, in billions of dollars and percents)

Activity	1987 Request (Dollars)	Real Growth: 1980-85 Average (Percent)	Real Growth: 1985-86 (Percent)	Real Growth: 1986-1987 Percent	Real Growth: 1986-1987 Dollars
Strategic Forces	6.1	3	-9	19	1.0
General Purposes Forces	26.3	8	-5	9	2.2
Intelligence and Communications	8.7	12	-1	20	1.4
Airlift and Sealift	1.8	13	-7	-1	0.0
Reserve Forces	6.5	6	-3	12	0.7
Central Supply and Maintenance	20.0	3	-9	9	1.6
Training, Medical and other	12.7	8	-5	15	1.6
Administration and Associated	3.4	9	-9	14	0.4
Support of other Nations	0.2	10	-13	45	0.1
Total	85.8	6	-6	12	9.0

SOURCE: Compiled by Congressional Budget Office, based on data supplied by the Department of Defense.

category. Two additional overhauls of strategic submarines are planned as well as reductions in maintenance backlogs. Centralized training, medical care, and administration funding would increase by about 14 percent for combined real growth of about $2 billion. O&M provides most of the funding for civilian employees of the Defense Department. The budget allows for a 3.0 percent civilian pay raise effective January 1, 1987, compared with the CBO baseline assumption of 3.3 percent effective October 1, 1986. Also, the Administration's allowance covers the full cost of the pay raise in defense compared with 50 percent in the request for nondefense agencies.

Procurement

The procurement account funds the purchase of weapons and other equipment. The weapons purchased in this account include new ships, aircraft, missiles, and combat vehicles like tanks. The procurement account also funds major modification or weapons improvement programs as well as spare and repair parts. Other purchases include trucks, bridging equipment, radios, and satellites. As shown in Table III-7, the procurement account is the only major funding category for which the 1987 budget request contains a real decline in budget authority--about 1 percent. In 1986 it experienced real decline of about 2 percent after growing at a 15 percent average annual rate in the preceding five years.

Support Equipment. The largest single activity within the procurement account for 1987 is support and other procurement. Its large absolute and relative size stems from the fact that "other" equipment is itself a large category and that all major weapons systems require general and sometimes specialized equipment for maintenance and test purposes. While not a part of actual weapon systems, these items are important parts of all weapons programs. In real terms, this category was unchanged in 1986 and would grow about 16 percent in 1987--the same average annual rate sustained in 1980-1985 period.

Aircraft. The next largest single category, aircraft procurement, would see real decline for the second consecutive year--a drop of about 22 percent in 1987 following a decline of about 9 percent in 1986. Aircraft procurement grew at an average annual rate of about 18 percent from 1980 through 1985. In terms of the numbers of aircraft, the Administration's budget calls for buying 870 aircraft in 1987 compared with about 889 in 1986--a decline of only 2 percent.

TABLE III-7. REAL GROWTH IN PROCUREMENT BUDGET AUTHORITY
(By fiscal year, in billions of dollars and percents)

Activity	1987 Request (Dollars)	Real Growth a/			
		1980-85 Average (Percent)	1985-1986 (Percent)	1986-1987	
				Percent	Dollars
Support and Other Equipment	22.4	16	-0	16	3.1
Aircraft	17.5	18	-9	-22	-5.0
Shipbuilding and Conversion	11.1	6	-8	4	0.4
Other Missiles, Torpedoes, and Weapons	9.9	18	7	6	0.6
Communications and Electronic Equipment	9.2	13	15	20	1.5
Spares and Repair Parts b/	7.0	24	-19	-1	-0.1
Vehicles, All Types c/	5.9	20	7	-24	-1.9
Modifications	5.5	9	-6	-7	-0.4
Ammunition, Munitions and Related Equipment	4.4	16	-6	6	0.3
Ballistic Missiles d/	2.9	-2	91	27	0.6
Total	95.9	15	-2	-1	-0.9

SOURCE: Compiled by Congressional Budget Office from data supplied by the Department of Defense.

a. Real growth computed using CBO's economic assumptions and the President's pay-raise assumptions.

b. Spares and repair parts for Navy weapon procurement, Navy "other" procurement, and Marine Corps procurement were not broken out in the DoD justification materials until 1986.

c. Includes Army weapons and tracked combat vehicles and purchases of National Guard and Reserve equipment, but excludes all Navy vehicles which are included in Support and Other Equipment.

d. Fiscal year 1985 does not include $1.5 billion of prior-year funds for the purchase of 21 MX missiles; if these funds were included in the analysis, the five-year average for ballistic missiles would be 16.1 percent and the growth between 1985 and 1986 would be -18.0 percent.

The budget shows a greater decline in costs than in aircraft procured for reasons that are not entirely clear at this time. The largest declines for individual aircraft occur for miscellaneous Army helicopters and Navy aircraft, the Air Force's KC-10 aerial refueling tankers, and the B-1 bomber (48 in 1986 to zero in 1987). The Air Force would also buy a cheaper mix of aircraft in that 120 of the 216 requested F-16s would be a stripped down variant. Another contributing factor to the relatively greater decline in costs might be lower unit costs through repricing and other factors.

Shipbuilding. The Administration's request of $11 billion for shipbuilding and conversion represents 4 percent real growth, slightly below the 6 percent average annual rate for the 1980-1985 period Despite the funding increase, three fewer ships would be purchased in 1987 than in 1986 (24 versus 27). This would occur because the 1987 request contains a more expensive mix of ships--the additional cost of one more major warship and auxiliary ship more than offsets the savings from buying three fewer amphibious ships and two fewer mine warfare and patrol ships.

Missiles. Funding for nonballistic missiles, torpedoes, and other weapons would continue to increase in real terms with growth of about 6 percent in 1987, compared with 7 percent in 1986 and a 18 percent annual average for 1980 through 1985. The many weapons funded in this area are not easily summarized, but examining the Administration's plan for tactical missile procurement reveals that the number purchased in 1987 would be about 4 percent lower than that for 1986. The program mix can influence the result, but certain missile programs show large increases in unit costs. For example, the rolling airframe missile has a unit cost four times greater than projected in the Administration's budget of a year ago. Similarly, compared with the Administration's 1986 projections, the advanced medium-range, air-to-air missile, AMRAAM, has unit costs 86 percent higher; the Chaparral missile is 75 percent more expensive; the Sidearm missile is 41 percent higher; a Phoenix missile costs 33 percent more; and the Harpoon is 21 percent more costly.

Communications Equipment. The Administration's budget proposes to purchase about $9 billion worth of communications and electronic equipment, ranging from radios for tactical forces to satellites for strategic communications. The request contains real growth of about 20 percent in 1987, which is an increase from the 15 percent rate in 1986 and the 13 percent annual average for the 1980-1985 period.

Vehicles. Funding for procurement of vehicles--primarily for the Army and Marine Corps--would decline in real terms by about 24 percent in 1987. In contrast, this budget activity averaged 20 percent annual real growth from 1980 through 1985 and 7 percent in 1986. This category buys all kinds of vehicles from trucks and other wheeled support vehicles to tanks and other tracked combat vehicles. Like the nonballistic missile category, the items funded in this category are not easily summarized. Focusing on major combat vehicles, the number of vehicles procured would fall from about 2,519 in 1986 to about 2,151 in 1987. The budget request would buy 21 percent, or 154 more, Bradley Fighting Vehicles in 1987, for a total of 870. Also, the budget contains funding for twice as many mobile command posts (300 in 1987 compared with 144 in 1986) and slightly more vehicles to carry artillery shells. Two systems that received funding in 1986 would not be funded in 1987--the armored personnel carrier, which is being replaced by the Bradley, and a recovery vehicle designed to retrieve other vehicles damaged in battle.

Modifications. The budget for weapons modification would decline in real terms for the second consecutive year; for the five years preceding 1986, it had grown on average by about 9 percent annually. Modifications of major weapons result in improvements ranging from small programs aimed at the reliability or maintainability of parts of a weapon to large-scale programs that add new capabilities to existing weapons or extend their useful lives. The request for 1987 contains a real decrease of about 7 percent--the result of a decrease in planned modification to Navy antisubmarine warfare aircraft and Army Apache attack helicopters. This decrease is slightly offset by planned increases in the Air Force for modifications for the F-15, KC-135, B-1B and C-5 aircraft.

Ammunition. Ammunition procurement, like spare parts procurement, is sometimes considered to be a readiness activity. The 1987 request would increase ammunition procurement 6 percent over the 1986 level; it fell 6 percent in real terms between 1985 and 1986. For the five years before 1986, this activity had grown about 16 percent each year.

Ballistic Missles. Procurement of ballistic missiles in 1987 would total about $2.9 billion--the least amount shown in Table III-7--for a real increase of about 27 percent. Two programs account for this growth, namely, the Trident II missile, of which the first 21 missiles is requested, and the MX, with a request for 21 missiles, the same number as funded in 1985, but 9 more than were funded in 1986. Both the Trident II and the MX would cost more than the Administration estimated a year ago. The 26 percent increase in unit costs for the MX stems partly from the lower number bought in 1986 and previously planned for 1987. Similarly, although this is the first procurement request for the Trident II, the Administration had planned to request 27 missiles in 1987 instead of 21.

In sum, the procurement budget for 1987 shows real growth in some activities and declines in others. The program contains many changes from the plan of a year ago; procurement is begun for some systems and ended for others. Overall, unit costs are about 1 percent less than the Administration projected last year, although a few systems--like the rolling airframe missile, AMRAAM, the Chaparral missile, and the Sidearm missile--show unusually high growth in unit costs.

Research, Development, Test, and Evaluation

RDT&E funding is usually the first commitment to a weapons acquisition program and it continues through the early stages of production. The Administration is seeking funds to continue the increases in RDT&E funding that have averaged 12 percent annually in real terms since 1980. RDT&E was one of only two major accounts to avert real decline in 1986--growing about 7 percent--and it would grow another 22 percent in 1987.

All aspects of the RDT&E account have significant growth in the 1987 request as shown in Table III-8. The technology base, in which pure research is conducted on subjects not necessarily restricted to weapons, would receive about a 7 percent increase. Advanced technology development would grow almost 60 percent, largely because of a proposed $2 billion increase in the Strategic Defense Initiative (SDI). Whereas programs like SDI take emerging technologies into the early stages of weapons acquisition, the request for RDT&E calls for a 21 percent real increase in strategic programs that have already passed these early developmental stages. The increase in strategic programs reflects a $1.4 billion commitment to research on a small ICBM--the so-called Midgetman--and $0.4 billion for research into how to base another 50 MX missiles.

The 20 percent real increase in tactical programs for 1987 results from a number of programs, the larger of which include a new attack submarine (the SSN-21) which would receive $0.3 billion; the C-17 cargo aircraft ($0.6 billion); and a tilt rotor aircraft ($0.4 billion). Intelligence and communications and defense-wide programs (that is, programs with many and diverse applications) both would increase by more than 10 percent in real terms under the Administration's budget.

Other Accounts

Military construction and family housing funds support both weapons and personnel programs. The Administration's request for military construction would fund many projects within the United States and overseas, including facilities for a new Army division at Fort Drum, New York; a Trident submarine base at Kings Bay, Georgia; and facilities related to deployment of other weapons, such as the B-1 bomber and the ground-launched cruise missile. The family housing program provides living accommodations for service members and their families, particularly in areas where private housing is scarce. The increase in funding for family housing would allow construction of 5,920 new housing units, operate and maintain about 400,000 other units, and lease yet another 28,000 housing units.

TABLE III-8. REAL GROWTH IN RESEARCH, DEVELOPMENT, TEST, AND EVALUATION (By fiscal year, in billions of dollars and percents)

Activity	1987 Request (Dollars)	Real Growth 1980-85 Average (Percent)	1985-86 (Percent)	1986-1987 Percent	Dollars
Technology Base	3.6	1	3	7	0.2
Advanced Technology Development	6.6	28	44	60	2.5
Strategic Programs	9.4	23	-8	21	1.6
Tactical Programs	12.7	5	12	20	2.1
Intelligence and Communications	5.1	22	11	12	0.5
Defense-wide Mission Support	4.6	8	1	14	0.6
Total	41.9	12	7	22	7.5

SOURCE: Compiled by Congressional Budget Office, based on data supplied by Department of Defense.

The Department of Energy (DOE) conducts research and production programs for nuclear weapons and materials. DOE also administers programs for storing nuclear waste and for designing reactors for nuclear-powered naval vessels. The President requested a real increase of about $800 million, or 9 percent, over the 1986 budget for these programs. The largest real percentage increase was for weapons, materials, production, and waste management, a 12 percent real increase.

CHAPTER IV

THE ADMINISTRATION'S NONDEFENSE BUDGET

The President's proposals would result in nondefense outlays totaling $713 billion in 1987, about the same as the 1986 level and $29 billion below the CBO baseline. Social Security and net interest account for half of these expenditures, but virtually none of the 1987 savings. Outlays for other nondefense activities would fall below the baseline by 7 percent in 1987 and 17 percent in 1991.

Over the period 1987 through 1991, the Administration's request would reduce nondefense spending by $309 billion below baseline levels. All but four nondefense functions are targeted for reductions. In only three of the four functions--International Affairs (150), General Science, Space, and Technology (250), and General Government (800)--would spending rise significantly above CBO baseline levels over the projection period. These increases largely result from higher proposed spending levels for the State Department to improve security for U.S. diplomatic missions abroad, for the National Aeronautics and Space Administration in 1990 and 1991 for a space station, and for the Internal Revenue Service. Outlays for the Administration of Justice (750) would remain near baseline levels throughout the period. Spending for these four functions would be about $11.5 billion above the baseline from 1987 through 1991 (see Table IV-1).

Reductions in human resources programs would exceed $160 billion over five years, accounting for more than half of the proposed nondefense reductions. For Social Security (650), which would experience the smallest reduction, benefit payments would be maintained at current law levels, and only administrative costs would be reduced. Medicare, however, would be targeted for the largest dollar reductions in any nondefense program, accounting for one-sixth of all proposed reductions in nondefense spending. Proposed increases in Medicare premiums and deductibles would be combined with reductions in payments to hospitals for capital and medical education and to physicians and other providers to reduce Medicare costs by almost $53 billion over five years.

TABLE IV-1. CBO ESTIMATE OF THE ADMINISTRATION'S PROPOSALS IN NONDEFENSE SPENDING (By fiscal year, in billions of dollars)

Budget Function	Increase or Decrease (-) in Outlays Relative to CBO Baseline 1987	1991	Total 1987-1991
Above Baseline Over Five Years			
International Affairs (150)	1.2	0.9	7.1
General Science, Space, and Technology (250)	a/	1.1	2.8
Administration of Justice (750)	0.1	-0.1	0.1
General Government (800)	0.5	-0.2	1.5
Subtotal	1.8	1.7	11.5
Below Baseline Over Five Years			
Human Resources			
Education, Training, Employment, and Social Services (500)	-3.6	-10.6	-36.3
Health (550)	-3.5	-7.1	-25.4
Medicare (570)	-4.7	-16.7	-52.8
Income Security (600)	-4.6	-10.8	-40.1
Social Security (650)	0.1	-0.4	-0.9
Veterans' Benefits and Services (700)	-0.6	-2.3	-7.0
Subtotal	-16.9	-47.9	-162.5
Natural and Physical Resources and Other Government Services			
Energy (270)	-0.8	-2.6	-8.4
Natural Resources and Environment (300)	-1.0	-3.5	-10.2
Agriculture (350)	-1.3	-2.9	-10.3
Commerce and Housing Credit (370)	-1.7	-4.4	-17.7
Transportation (400)	-1.8	-5.9	-19.5
Community and Regional Development (450)	-1.4	-3.3	-13.6
General Purpose Fiscal Assistance (850)	-4.4	-4.8	-23.6
Subtotal	-12.4	-27.4	-103.3
Other			
Net Interest (900)	-0.2	-10.7	-24.4
Allowances (920)	-0.4	-4.8	-11.3
Undistributed Offsetting Receipts (950)	-0.9	-1.5	-19.4
Subtotal	-1.5	-17.0	-55.1
Total	-29.0	-90.6	-309.4

a. Less than $50 million.

Other federal health spending would also be reduced sharply. Federal Medicaid spending would be capped below baseline levels in 1987 and allowed to grow only with increases in medical prices. Payments for the Public Health Service would be reduced, as would payments for Federal Employees Health Benefits. Finally, a means test would be applied to veterans using the Veterans Administration hospital system. Altogether these proposed reductions in Medicare and in other federal health care expenditures would save $82 billion over the five years, over one-fourth of all proposed nondefense changes.

Income Security (600) and Education, Training, Employment, and Social Services (500) are also targeted for large reductions--$40 billion and $36 billion, respectively, over five years. The President's proposals for income security would eliminate 1987 cost-of-living adjustments in civilian and military retirement systems, further reduce civilian retirement benefits, sharply cut rental assistance and public housing programs, and eliminate nutritional assistance to children from families with incomes above 185 percent of the poverty level. The largest reductions in education, training, employment, and social service programs are proposed in student aid and guaranteed student loans. Deep reductions are also proposed in funding for summer youth employment, job corps, and assistance for dislocated workers. In social service programs, the community services block grant would be eliminated, and many programs would be funded at or near their 1986 levels.

In programs affecting natural and physical resources and other government services, the total dollar reduction would be about $103 billion over five years, only two-thirds of that in the human resources programs. The percentage reduction, however, would be much larger--24 percent, compared with 6 percent for human resources programs. The Commerce and Housing Credit (370) and General Purpose Fiscal Assistance (850) functions are targeted for reductions of 83 percent and 71 percent below baseline over five years (see Table IV-2). These reductions arise primarily from the proposed elimination of the Small Business Administration, the Farmers Home Administration rural housing programs, and General Revenue Sharing. The elimination of these three programs alone is estimated to save almost $39 billion (less about $2 billion in offsetting interest losses in function 900).

Proposed reductions in Energy (270) and in Community and Regional Development (450) exceed 30 percent over five years. The President's largest cut in energy programs would occur in the Rural Electrification Administration, with both direct and guaranteed loans eliminated by 1990. Federal energy research and development efforts would be curtailed, and spending for conservation programs and the Strategic Petroleum Reserve virtually eliminated. Many community and regional development programs are slated for elimination. The largest savings would come from eliminating

TABLE IV-2. CBO ESTIMATE OF THE ADMINISTRATION'S PROPOSALS IN NONDEFENSE SPENDING (By fiscal year, in percent differences from the CBO baseline)

Budget Function	Percent Increase or Decrease (-) in Outlays Relative to Baseline 1987	1991	Total 1987-1991
Above Baseline Over Five Years			
International Affairs (150)	8	5	9
General Science, Space, and Technology (250)	a/	11	6
Administration of Justice (750)	1	-1	a/
General Government (800)	9	-4	5
Below Baseline Over Five Years			
Human Resources			
Education, Training, Employment, and Social Services (500)	-12	-29	-22
Health (550)	-9	-14	-12
Medicare (570)	-6	-14	-11
Income Security (600)	-4	-7	-6
Social Security (650)	a/	a/	a/
Veterans' Benefits and Services (700)	-2	-8	-5
Natural and Physical Resources and Other Government Services			
Energy (270)	-16	-46	-32
Natural Resources and Environment (300)	-8	-25	-15
Agriculture (350)	-6	-23	-11
Commerce and Housing Credit (370)	-35	-176	-83
Transportation (400)	-7	-20	-14
Community and Regional Development (450)	-18	-40	-35
General Purpose Fiscal Assistance (850)	-72	-69	-71
Other			
Net Interest (900)	a/	-7	-3
Allowances (920)	-34	-45	-40
Undistributed Offsetting Receipts (950) b/	-3	-3	-9

a. Less than 0.5 percent.

b. Offsetting receipts rise, decreasing the deficit.

new disaster loans under the Small Business Administration beginning in 1987, eliminating Urban Development Action Grants, and reducing funding for community development block grants. Savings in these two functions would total $22 billion over the 1987-1991 period.

The budget includes smaller reductions of between 11 percent and 15 percent for three other functions. The President is proposing reductions totaling almost $20 billion in Transportation (400) by eliminating funding for Amtrak, sharply reducing funding for mass transit, and cutting highway and airport grants as well as maritime subsidies. Another $10 billion in savings would be obtained in Natural Resources and Environment (300) by phasing out the construction grants program of the Environmental Protection Agency and by reducing spending for conservation, forestry, and other natural resources activities. In Agriculture (350), the largest savings would result from eliminating disaster loans and phasing out other direct loans in the Agricultural Credit Insurance Fund. Crop insurance subsidies would be eliminated, export credit fees increased, and funding for the Extension Service would be sharply cut, for total savings in agriculture programs of $10 billion over the five-year period.

The President proposes to limit pay rate increases to 3.0 percent each year for civilian employees. However, for 1987, the budget includes only 50 percent of the funds for such an increase for nondefense agencies, thereby requiring those agencies to reduce other activities to pay for part of the increase. The CBO baseline assumes increases averaging over 5 percent per year based on projected growth in private-sector pay. Primarily as a result of these differences, the baseline spending in Allowances (920) would be reduced almost 40 percent by the President's request.

The President's proposals would increase Undistributed Offsetting Receipts (950) by $19 billion through 1991. The major saving would result from the proposed sale of the government's interest in the Naval Petroleum Reserves and five power marketing administrations. Receipts from these sales are estimated to total nearly $15 billion, but receipts generated by these assets would be reduced by almost $4 billion through 1991, and by additional amounts in subsequent years.

The President's proposals for nondefense spending are discussed in more detail, by budget function, on the following pages.

FUNCTION 150: INTERNATIONAL AFFAIRS

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 150: INTERNATIONAL AFFAIRS (By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	15.3	15.8	15.8	16.0	16.6	
Proposed Changes						
Administration of Foreign Affairs	0.4	0.8	1.0	0.9	0.8	4.0
Export Financing	0.1	0.3	0.3	0.3	0.2	1.1
Foreign Military Sales Financing	0.3	0.2	0.3	0.2	0.1	1.1
Other Security Assistance	0.3	0.3	0.2	0.2	0.1	1.0
Broadcast Services	0.1	0.2	0.2	0.2	0.2	0.8
Other Development Assistance	0.1	a/	-0.2	-0.3	-0.4	-0.8
Other	-0.1	a/	a/	-0.1	-0.1	-0.3
Total	1.2	1.7	1.8	1.5	0.9	7.1
President's 1987 Budget as Estimated by CBO	16.5	17.5	17.7	17.4	17.5	
President's 1987 Budget	18.6	18.3	18.0	17.5	17.7	
CBO Reestimates	-2.1	-0.7	-0.4	a/	-0.2	-3.5

a. Less than $50 million.

Proposed Policy Changes

For international affairs, the President is proposing spending above baseline levels in all years, with increases totaling $7.1 billion, or 9 percent, over the 1987-1991 period. The largest increase is for administration of foreign affairs, reflecting a five-year program in the State Department to improve security of U.S. diplomatic missions abroad. Proposed funding for the new security program totals $4.4 billion for 1986 through 1990, including a 1986 supplemental of $0.7 billion. The security program includes requests for appropriations of $2.7 billion for embassy construction, $1.6 billion for salaries and expenses, and $0.1 billion for counterterrorism research and development. As a result, outlays for administration of foreign affairs are $4.0 billion above baseline over the 1987-1991 period.

Export Financing. The President's budget includes two changes in programs of government-assisted export financing. The Administration is requesting a one-time appropriation of $300 million for a "war chest" in the Department of the Treasury to provide grants of 25 percent or more of the value of the export to foreign customers of U.S. goods. The grants are to support U.S. negotiations with other exporting countries to end the abuse of highly concessional credits for commercial advantage. Outlays for this program are estimated to add $0.2 billion in 1987-1991 to CBO's baseline.

In addition to the war chest, the President's budget includes an interest subsidy program for the Export-Import Bank (Eximbank). The President is requesting authority to obligate $1.8 billion in subsidized loans in 1987 and to finance the loans through a guarantee of the timely payment of loan principal and interest against all risk. The subsidized loans are the same to the borrower and the exporter as the existing direct loans; only the means of financing is changed. The proposed guaranteed financing is equivalent to an agency debt transaction. In this analysis, CBO has recorded the subsidized loans as direct loans rather than as loan guarantees, the approach used in the President's budget. Higher loan levels would increase outlays over baseline by $0.1 billion in fiscal year 1987 and by $0.9 billion over the five-year period. (For further discussion of the subsidized loan program, see Appendix A.)

Foreign Military Sales and Other Security Assistance. Proposed funding for foreign military sales is above the CBO baseline by $0.7 billion in 1987 and by $1.9 billion over the 1987-1991 period. As a result, outlays over the five-year period would be $1.1 billion above baseline levels. The request includes 1987 funding for Israel and Egypt at 1986 presequestration levels. The Administration is also seeking increases in other security assistance programs. It proposes to restore both the sequestered amounts and the $1.0 billion cut in security assistance appropriations previously enacted for 1986.

Broadcast Services. The President's budget also includes an increase in funding for foreign information and exchange activities, with outlays $0.8 billion above baseline levels over the 1987-1991 period. This increase is mainly attributable to the modernization and expansion of transmission sites for the Voice of America and Radio Free Europe/Radio Liberty.

Other Development Assistance. Increases in funding for Public Law 480 food assistance are requested to maintain tonnage shipments at 1986 levels. These shipments were partially funded through carry-over balances in 1986. The increases in Public Law 480 are offset by cuts in other development programs, the only major program area in this function targeted for cuts below the baseline. The President's budget provides increases at half the rate of inflation for bilateral aid and includes no increases or provisions for arrearages for the multilateral development banks.

Other Proposals. The President is requesting an additional $100 million capitalization for the Special Defense Acquisition Fund (SDAF). This shifts $0.1 billion in offsetting receipts from the defense function to offsetting collections in SDAF. The President has not requested recapitalization of the Guarantee Reserve Fund, which presently is thinly capitalized. The fund's reserves were only $271 million in 1986 against $20 billion in outstanding guarantees. In December 1985, one-quarter of these reserves was consumed when a country missed a scheduled payment.

CBO Reestimates

CBO has lowered the President's outlay estimates for foreign military sales by $2.1 billion in 1987 and $6.0 billion over the 1987-1991 period, reflecting large balances of undisbursed and uncommitted funds. Since some countries, particularly those that have granted the U.S. Department of Defense rights to use certain facilities, historically have received new financing in excess of new sales, CBO assumes the increase in new financing will add only marginally to outlays and, thus, projects that uncommitted or unused balances of foreign military sales credits will rise.

CBO has recorded the interest subsidy loans in the Eximbank as direct loans rather than loan guarantees, as treated in the President's budget. As a result, CBO has increased the President's outlay estimate for the Eximbank by $0.3 billion in 1987 and $3.2 billion over the 1987-1991 period.

Credit Programs

The President is requesting an increase of $0.5 billion for foreign military sales credits in fiscal year 1987, and an increase of $1.2 billion for the five-year period. The Administration's budget also proposes slightly higher levels of direct loans for Public Law 480 and the economic support fund in 1987. The request for these direct loan programs grows at half the rate of inflation in the years 1988 through 1991.

The President is requesting to eliminate the Agency for International Development's Housing Investment Guarantee program in fiscal year 1987 and to privatize the Overseas Private Investment Corporation by 1989.

In fiscal year 1986, the Eximbank has authority for $1.1 billion in direct loans and $11.5 billion in guarantees and insurance. The 1987 request is for a limit of $12.0 billion in guaranteed loans, of which $1.8 billion is for interest subsidized loans. CBO views the interest subsidized loans to be the equivalent of direct loans, which results in an increase of $0.7 billion in fiscal year 1987 over the CBO baseline and $3.0 billion for the 1987-1991 period. The proposal for Eximbank guarantees and insurance is $1.8 billion less than projected in the CBO baseline. The Administration's request has no increase for inflation, which reduces the total limits for subsidized loans and guarantees and insurance for the five-year period by $13.9 billion.

The major changes proposed for the credit programs in this budget function are summarized in the table on the following page.

MAJOR CREDIT PROGRAM CHANGES PROPOSED FOR FUNCTION 150: INTERNATIONAL AFFAIRS (By fiscal year, in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
Direct Loan Obligations						
CBO Baseline	8.8	9.0	9.3	9.7	10.0	
Proposed Changes						
Foreign Military Sales	0.5	0.4	0.3	0.1	-0.1	1.2
Eximbank	0.7	0.6	0.6	0.6	0.5	3.0
Other	0.1	0.1	a/	-0.1	-0.2	-0.1
Total	1.2	1.1	0.9	0.6	0.3	4.1
President's 1987 Budget as Estimated by CBO	10.0	10.1	10.2	10.3	10.3	
Guaranteed Loan Commitments						
CBO Baseline	12.2	12.8	13.3	13.8	14.4	
Proposed Changes						
OPIC	a/	a/	-0.2	-0.2	-0.2	-0.5
AID (Housing Investment Guarantees)	-0.2	-0.2	-0.2	-0.2	-0.2	-0.8
Eximbank	-1.8	-2.2	-2.8	-3.3	-3.8	-13.9
Total	-1.9	-2.4	-3.1	-3.6	-4.2	-15.2
President's 1987 Budget as Estimated by CBO	10.3	10.3	10.2	10.2	10.2	

a. Less than $50 million.

FUNCTION 250: GENERAL SCIENCE, SPACE, AND TECHNOLOGY

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 250: GENERAL SCIENCE, SPACE, AND TECHNOLOGY
(By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	9.1	9.4	9.8	10.3	10.8	
Proposed Changes						
National Science Foundation	0.1	0.1	0.1	0.1	0.0	0.4
Department of Energy (General science)	0.1	0.1	0.1	0.2	0.2	0.7
National Aeronautics and Space Administration	-0.1	-0.2	0.2	1.0	0.9	1.8
Total	a/	a/	0.5	1.2	1.1	2.8
President's 1987 Budget as Estimated by CBO	9.1	9.4	10.3	11.5	11.9	
President's 1987 Budget	9.2	9.3	10.2	11.0	11.7	
CBO Reestimates	-0.1	0.2	0.1	0.5	0.3	1.0

a. Less than $50 million.

Proposed Policy Changes

The President proposes spending at or above baseline levels in all years for the basic research programs and National Aeronautics and Space Administration (NASA) activities in this function. The major increase relative to the CBO baseline is for NASA, primarily in fiscal years 1990 and 1991, for the proposed space station. The space station is expected to be in operation by the mid-1990s, and funding in the budget grows rapidly from a fiscal year 1986 base of about $200 million to around $2 billion annually beginning in fiscal year 1990. (The CBO baseline assumes funding for the space station at 1986 levels, adjusted for inflation.) Neither the President's budget nor the baseline reflects the possible consequences of the recent explosion of the space shuttle Challenger. Significant budgetary changes will likely result, especially if the decision is made to build another shuttle orbiter.

For the National Science Foundation (NSF), the President's budget proposes spending increases of almost $150 million above the CBO baseline in fiscal year 1987. This increase would fund more research grants and provide additional resources for science and engineering education activities. The budget also includes an increase of about $90 million above the baseline in 1987 for the general science programs of the Department of Energy (DOE), including funding to upgrade the current accelerator facilities and to construct a new electron accelerator. Proposed funding for the NSF and DOE research activities is above baseline levels throughout the 1987-1991 period.

CBO Reestimates

CBO reestimates result primarily from differences in projected spending rates, especially for space station activities in 1990 and 1991.

FUNCTION 270: ENERGY

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 270: ENERGY (By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	5.2	5.3	5.3	5.4	5.6	
Proposed Changes						
Rural Electrification	-0.3	-0.6	-1.0	-1.4	-1.8	-5.1
Energy R&D	-0.1	-0.4	-0.5	-0.7	-0.9	-2.6
Conservation	-0.1	-0.3	-0.4	-0.4	-0.4	-1.6
Strategic Petroleum Reserve	-0.2	-0.3	-0.3	-0.3	-0.3	-1.5
Uranium Enrichment	-0.1	-0.2	-0.2	-0.2	-0.2	-0.9
Naval Petroleum Reserves a/	b/	0.8	0.7	0.6	0.6	2.6
Power Marketing Administrations a/	b/	-0.1	b/	0.5	0.6	1.0
Nuclear Waste Disposal	b/	0.1	0.1	0.1	0.1	0.3
Other	b/	-0.2	-0.2	-0.2	-0.3	-0.6
Total	-0.8	-1.2	-1.8	-2.0	-2.6	-8.4
President's 1987 Budget as Estimated by CBO	4.4	4.1	3.4	3.3	3.1	
President's 1987 Budget	4.0	4.5	3.9	3.7	3.9	
CBO Reestimates	0.4	-0.4	-0.5	-0.4	-0.8	-1.8

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a. The receipts from the proposed sale of the Naval Petroleum Reserves and the power marketing administrations are shown in function 950. Function 270 outlays would increase, relative to the baseline, after the proposed asset sales, because these assets would no longer generate receipts for the government.

b. Less than $50 million.

Proposed Policy Changes

The President is proposing substantial cuts in energy programs, which would reduce outlays by 16 percent below the baseline in 1987, and by 46 percent in 1991. Outlay savings would total $8.4 billion over the 1987-1991 period, or almost one-third of projected baseline spending for the five years. These savings are net of losses in receipts that would result from the proposed sale of the power marketing administrations (PMAs) and the Naval Petroleum Reserves (NPR). Excluding the reduction in receipts, outlay savings would total over $12 billion from 1987 through 1991.

Rural Electrification. The largest savings would occur in activities of the Rural Electrification Administration (REA). The President would phase out REA's direct and guaranteed loans by 1990, while increasing the interest rate on remaining direct loans; would levy a fee on power supply borrowers to cover the cost of loan defaults; and would sell a portion of REA's direct loan portfolio.

Reducing REA's lending costs would lower outlays by a total of $5.1 billion over the next five years. Most of this reduction, or about $3.3 billion, results from phasing out new direct and guaranteed loans. Imposing a fee on power supply borrowers to recover the cost to the government of loan defaults would reduce outlays by an additional $1.2 billion over the five years relative to CBO's baseline assumptions. Income from selling portions of the direct loan portfolio accounts for most of the remaining savings.

Energy Research and Development. Under the President's proposed budget, federal efforts in energy research and development for fossil, nuclear, solar, and other energy technologies would be reduced by about $2.6 billion over the 1987-1991 period.

Conservation. Conservation spending would be reduced by $1.6 billion over five years under the President's plan. Most of this reduction results from the proposed elimination of conservation grants. The budget proposal asserts that states are expected to receive significant funds for conservation as a result of the settlement of federal cases involving the alleged violation of oil price controls. For example, a recent court ruling directed that over $2.0 billion in oil price overcharges be disbursed to the states.

Strategic Petroleum Reserve. The President proposes to stop filling the Strategic Petroleum Reserve at the end of 1986, when the reserve will contain approximately 500 million barrels. Current policy calls for a reserve of 750 million barrels. The President proposes a moratorium on increased oil reserves at the 500 million barrel level and reprogramming of facilities development funds to maintain the current reserve without increasing storage capacity to the 750 million barrel goal. A five-year moratorium on both additional oil reserves and new capacity development would save $1.5 billion, relative to current policy.

Uranium Enrichment. Reducing spending in uranium enrichment activities would enable the program to pay the Treasury for past federal investments, thereby reducing outlays by about $0.9 billion by 1991.

Naval Petroleum Reserves and Power Marketing Administrations. Income from the sale of the power marketing administrations and Naval Petroleum Reserves appears in budget function 950, and are estimated to total $14.8 billion over the 1987-1991 period. These savings would be partially offset, however, by an increase in outlays in budget function 270, because these assets would no longer generate receipts for the government. By 1991, net outlays would increase in function 270 by $1.0 billion because of the sale of the PMAs, and by $2.6 billion because of the sale of the Naval Petroleum Reserves. Outlay increases would continue in subsequent years.

Nuclear Waste Disposal. Spending on nuclear waste activities would increase by a total of $0.3 billion over the five-year period. The baseline includes the President's proposed spending for developing the first and second nuclear waste repositories; the budget also reflects an increase in management, research, and other activities.

Other. Proposed increases in Federal Energy Regulatory Commission fees would reduce outlays by a total of $0.3 billion by 1991. Reduced spending in other regulatory and administrative programs would lower outlays by a total of $0.3 billion over the next five years.

CBO Reestimates

CBO estimates of the President's budget outlays are above the Administration's figures by $0.4 billion in 1987 but are below them in 1988 through 1991. As a result, the CBO outlay projections are $1.8 billion below the Administration's for the five-year period.

CBO assumes that sale of the Naval Petroleum Reserves will occur in 1988 rather than 1987, which means that the government would receive a full year of receipts in 1987. These additional receipts would lower 1987 outlays by $0.4 billion. CBO estimates for other programs exceed the Administration's by about $0.8 billion in 1987. They reflect higher estimated spending by the REA, a lag in implementing repayment reforms for the Bonneville Power Administration, and higher spending rates for a number of other programs.

Reestimates for 1988 through 1991 reflect CBO's different assumption about the timing of the sale of the Bonneville Power Administration (see budget function 950), which results in larger receipts in 1988 and 1989. They also reflect higher estimates of REA receipts in 1990 and 1991, and lower estimates of spending by the Tennessee Valley Authority and in several other programs.

Credit Programs

The President proposes to phase out REA's direct and guaranteed loan programs by 1990, and to increase the interest rate on any future direct loans. Under this policy change, REA's direct loans, which currently bear interest at 5 percent, would be reduced by a total of about $4.0 billion over the next five years. Terminating the REA guaranteed-loans program would reduce federal lending activity by a total of $4.8 billion by 1991, because virtually all of the guaranteed loans are financed by the Federal Financing Bank (FFB).

MAJOR CREDIT PROGRAM CHANGES PROPOSED FOR FUNCTION 270: ENERGY (By fiscal year, in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
			Direct Loan Obligations			
CBO Baseline	2.1	2.2	2.2	2.3	2.4	
Proposed Changes						
Rural Electrification	-0.5	-0.6	-0.8	-1.0	-1.1	-4.0
Rural Electrification (FFB Loans)	-0.7	-0.9	-1.0	-1.1	-1.1	-4.8
Total	-1.2	-1.5	-1.8	-2.1	-2.2	-8.8
President's 1987 Budget as Estimated by CBO	0.9	0.6	0.4	0.1	0.1	

FUNCTION 300: NATURAL RESOURCES AND ENVIRONMENT

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 300: NATURAL RESOURCES AND ENVIRONMENT
(By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	13.1	14.1	13.9	14.0	14.3	
Proposed Changes						
Construction Grants	[a]	-0.1	-0.4	-0.9	-1.5	-2.9
Soil and Water Conservation	-0.3	-0.4	-0.5	-0.5	-0.6	-2.4
Forest Service	-0.2	-0.2	-0.3	-0.3	-0.4	-1.3
NOAA Operations, Research and Facilities	-0.2	-0.2	-0.3	-0.4	-0.4	-1.5
Land Acquisition	-0.1	-0.1	-0.1	-0.1	-0.1	-0.6
Bureau of Reclamation	0.1	0.2	0.2	0.2	0.2	0.8
Corps of Engineers						
Spending	0.2	0.4	0.5	0.6	0.6	2.4
Receipts	-0.3	-0.3	-0.3	-0.5	-0.5	-1.9
Other	-0.3	-0.6	-0.5	-0.8	-0.8	-2.9
Total	-1.0	-1.3	-1.7	-2.7	-3.5	-10.2
Other Adjustments [b]	-0.1	-0.9	-0.4	-0.3	-0.3	-2.0
President's 1987 Budget as Estimated by CBO	12.0	11.9	11.8	11.1	10.4	
President's 1987 Budget	12.0	11.8	11.7	11.2	10.7	
CBO Reestimates	[a]	0.1	0.1	-0.1	-0.3	-0.2

a. Less than $50 million.

b. CBO's estimate of the President's budget includes additional changes from the baseline in the outlay estimates for the Environmental Protection Agency's construction grant program, to reflect technical adjustments made after completion of the baseline.

Proposed Policy Changes

While the President's budget proposes increased spending in 1987 for Bureau of Reclamation and Corps of Engineers water resource programs, these proposed increases are more than offset by reductions for most other natural resources and environment activities. CBO estimates that enactment of the President's proposals would result in net outlay savings from the CBO baseline of $1.0 billion in 1987 and $10.2 billion over the 1987-1991 period. The budget proposals would reduce spending for this function by 15 percent below baseline levels over the five years.

The largest savings in this function would result from the Administration's proposal to phase out the construction grants program of the Environmental Protection Agency beginning in 1987. New funding would be limited to projects already under way, and budget authority would fall from $2.4 billion in 1986 to zero by 1990. Outlay savings would total $2.9 billion through 1991.

The President's budget would also reduce spending by shifting the focus of soil and water conservation activities as a result of the new conservation reserve program (in budget function 350, Agriculture) authorized by the Food Security Act of 1985. Except for Soil Conservation Service technical assistance of $0.4 billion a year to support the conservation reserve, the budget proposes to eliminate by 1988 the current soil and water conservation activities of the Agricultural Stabilization and Conservation Service and the Soil Conservation Service. Savings from these reductions would total $0.3 billion in 1987 and $2.4 billion over the 1987-1991 period.

Additional savings totaling $6.3 billion through 1991 would be obtained through a variety of other program reductions in the Agriculture, Commerce, and Interior Departments. The budget contains a 12 percent decrease from 1986 to 1987 for existing Forest Service programs, with funding frozen at about the 1987 level thereafter. The decrease reflects a reduction in planned timber sales and associated road construction, termination of forestry grants to states, and reduction of forest research funds for projects determined to directly support private industry. Requested budget authority for the National Oceanic and Atmospheric Administration's (NOAA) operations research and facilities account is about $0.2 billion, or about 21 percent less than the fiscal year 1986 level. Significant cuts are proposed for several NOAA programs, including most ocean and coastal activities (sea grants would again be slated for termination) and marine fisheries activities. Requested budget authority for NOAA reflects no additional subsidies for Landsat and assumes a one-satellite polar orbiting system. The proposed reduction would be partially offset by a $50 million increase in the transfer from the Airport and Airways Trust Fund for the aviation weather services program and other activities.

The Administration has also proposed overall cuts in spending for land acquisition and recreational construction in this function, as well as new offsetting receipts of about $100 million a year from additional recreation user fees. These receipts would be earmarked for operation and maintenance of Forest Service and Park Service facilities rather than being deposited in the Land and Water Conservation Fund, as is now done. For federal land management activities of the Bureau of Land Management, the President's budget proposes reductions from 1986 to 1987 of less than 2 percent, with the Bureau of Indian Affairs conservation activities slated for a 7 percent reduction.

The reductions in other areas are partially offset by increased spending for water projects of the Bureau of Reclamation and the Corps of Engineers. The Administration has proposed a 19 percent increase in funding over fiscal year 1986 levels for the Bureau's activities, or 10 percent above the baseline. Outlays over the 1987-1991 period would be about $0.8 billion above baseline levels. Most of the increase is proposed for accelerated activity on continuing the Bureau's construction projects.

The Administration's budget proposes 1987 funding of $3.3 billion for the Army Corps of Engineers. This represents an 18 percent increase over fiscal year 1986 levels and an 11 percent increase over the baseline. Most of the increase is proposed to begin work on 19 new construction projects and to continue construction on 41 projects authorized in the 1985 supplemental appropriation. These plans assume enhanced cost-sharing arrangements with nonfederal interests. The spending increase would be partially offset by $0.3 billion to $0.5 billion per year in new user fees for deep draft navigation. Additional revenues from the increases in the barge fuel tax for the inland waterway system are estimated to total less than $50 million over the 1987-1991 period. In total, additional revenues and receipts would cover $1.9 billion of the Corps' $2.4 billion in additional spending over the 1987-1991 period.

CBO Reestimates

CBO's outlay estimates do not differ significantly from the Administration's estimates for this function.

FUNCTION 350: AGRICULTURE

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 350: AGRICULTURE (By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	23.2	24.7	21.1	15.8	12.9	
Proposed Changes						
Agricultural Credit Insurance Fund	-0.7	-0.2	-0.7	-1.1	-1.1	-3.8
Federal Crop Insurance	-0.1	-0.3	-0.4	-0.5	-0.6	-1.9
Commodity Credit Corporation	-0.1	-0.3	-0.4	-0.5	-0.5	-1.9
Extension Service	-0.2	-0.2	-0.2	-0.3	-0.3	-1.1
Other	-0.2	-0.2	-0.4	-0.4	-0.4	-1.6
Total	-1.3	-1.2	-2.1	-2.8	-2.9	-10.3
President's 1987 Budget as Estimated by CBO	21.9	23.5	19.0	13.0	10.0	
President's 1987 Budget	19.5	19.7	18.9	15.4	11.4	
CBO Reestimates	2.3	3.8	0.1	-2.4	-1.4	2.4

Proposed Policy Changes

The President's budget proposes spending reductions in the agriculture function by reducing federal subsidies or charging fees for activities that benefit specific groups, and cutting back on certain research and education programs. Total savings relative to the CBO baseline would be $10.3 billion over the 1987-1991 period, with spending 23 percent below the baseline level at the end of the period. Furthermore, outlays are expected to drop sharply under current law, primarily as a result of changes in price support programs enacted in the Food Security Act of 1985. Consequently, total outlays for agriculture programs would drop from $30.4 billion in 1986 to an estimated $10.0 billion in 1991.

The largest outlay savings from proposed policy changes would occur in the Agricultural Credit Insurance Fund (ACIF). Emergency disaster loans would be eliminated in 1987, and other direct loans would be phased out by 1990. (The CBO baseline maintains direct loans at levels projected from 1988 loan limits specified in the Food Security Act of 1985.) There would be no direct loan obligations in 1990 (compared with $2.0 billion in 1986), while guaranteed loans would increase from $1.9 billion in 1986 to $4.0 billion in 1991. Resulting outlay savings would total $3.8 billion over the five-year period.

The President's budget would also phase out support for the Federal Crop Insurance Corporation over a five-year period. Currently, farmer premiums are subsidized, and federal funds are used to cover administrative and operating expenses of the corporation. The Administration intends to continue to operate the crop insurance program, but with participants eventually bearing all the costs. Annual savings would reach $0.6 billion by 1991.

Commodity Credit Corporation (CCC) spending would also be reduced by an increase in origination fees for export credit guarantees. In addition, the President is proposing to reduce the required level of export credit loan guarantees from $5.5 billion per year to $3.0 billion per year beginning in 1987. This reduction in guarantee levels would cause lower outlays for direct loans in later years because of reduced claims for defaulted loans. Savings as a result of increased fees and reduced guarantee claims would grow from $140 million in 1987 to $530 million in 1991.

Further savings would be obtained by a sharp reduction in funding for the Extension Service, from $328 million in 1986 to $140 million annually beginning in 1987. All categorical programs, the largest of which is the Expanded Food and Nutrition Education Program, would be eliminated. Savings would total $1.1 billion over the 1987-1991 period.

Other proposed spending reductions in the President's budget result from new and expanded user fees in marketing and inspection service programs, including grain inspection, activities of the Packers and Stockyards Administration, and services to agricultural cooperatives. In addition, no further funding is being requested for the Temporary Emergency Food Assistance Program.

CBO Reestimates

Most of the CBO outlay reestimate is for the Commodity Credit Corporation, as the result of differing assumptions concerning the supply and use of supported commodities and the Secretary of Agriculture's use of discretion in implementing the support programs. In the first two years, the reestimates result primarily from differences in assumptions about advanced deficiency payments. The CBO estimates assume that advanced deficiency payments would be made on the 1987 crops and in subsequent years, following the policies already announced for the 1986 crop. The Administration, on the other hand, assumes that no advanced payment would be made on crops after 1986. The ACIF also contributes to the upward reestimate during the first three years, largely because CBO has projected lower loan repayments from the existing portfolio than are implicit in the President's budget estimates.

Credit Programs

As indicated above, the President's budget proposes reductions in loan guarantees and in resulting direct loans made by the CCC. The Administration also seeks to eliminate ACIF direct lending, while increasing guarantees. These proposals are summarized in the table on the following page.

MAJOR CREDIT PROGRAM CHANGES PROPOSED FOR FUNCTION 350: AGRICULTURE (By fiscal year, in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
Direct Loan Obligations						
CBO Baseline	14.3	12.1	11.3	10.0	9.4	
Proposed Changes						
Agricultural Credit Insurance Fund	a/	a/	-0.6	-1.1	-1.2	-3.0
Agricultural Credit Insurance Fund (Disaster)	-0.7	-0.1	-0.1	-0.1	-0.1	-1.1
Commodity Credit Corporation	a/	-0.2	-0.3	-0.4	-0.4	-1.2
Total	-0.8	-0.3	-1.0	-1.6	-1.6	-5.3
President's 1987 Budget as Estimated by CBO	13.5	11.8	10.4	8.5	7.8	
Guaranteed Loan Commitments						
CBO Baseline	8.0	8.5	8.6	8.8	8.9	
Proposed Changes						
Agricultural Credit Insurance Fund	a/	a/	0.4	0.7	0.6	1.7
Commodity Credit Corporation	-2.5	-2.5	-2.5	-2.5	-2.5	-12.5
Total	-2.5	-2.5	-2.1	-1.8	-1.9	-10.8
President's 1987 Budget as Estimated by CBO	5.5	6.0	6.5	7.0	7.0	

a. Less than $50 million.

FUNCTION 370: COMMERCE AND HOUSING CREDIT

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 370: COMMERCE AND HOUSING CREDIT
(By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	4.0	5.3	3.6	3.6	2.3	
Proposed Changes						
Rural Housing Insurance Fund	-1.4	-1.9	-2.1	-2.2	-2.2	-9.9
Small Business Administration	-0.7	-1.4	-1.4	-1.5	-1.1	-6.1
Housing for the Elderly or Handicapped	-0.1	-0.2	-0.4	-0.5	-0.6	-1.8
Federal Housing Administration	-0.2	-0.4	-0.4	-0.3	-0.2	-1.5
Guarantees of Mortgage-Backed Securities	a/	-0.1	-0.1	-0.2	-0.2	-0.6
U.S. Postal Service	0.7	1.0	0.3	0.4	0.1	2.5
Other	a/	a/	-0.1	-0.2	-0.1	-0.4
Total	-1.7	-2.9	-4.2	-4.5	-4.4	-17.7
Other Adjustments b/	0.8	2.0	-0.5	-0.1	0.2	2.4
President's 1987 Budget as Estimated by CBO	3.1	4.3	-1.1	-1.0	-1.9	
President's 1987 Budget	1.4	3.8	-0.5	-1.0	-1.8	
CBO Reestimates	1.8	0.5	-0.6	a/	-0.1	1.6

a. Less than $50 million.

b. CBO's estimate of the President's budget includes additional changes from the baseline totaling $2.4 billion over five years, to reflect technical adjustments in the Postal Service estimates made after completion of the baseline.

Proposed Policy Changes

The President proposes terminating or reducing a number of programs that currently support commerce or housing activities, on the grounds of removing the federal government from activities that the Administration believes compete directly with the private sector. Over $4 billion a year in spending would be eliminated by 1989, and offsetting receipts and collections in this function would exceed spending by that time. CBO estimates that enactment of the President's proposals for this budget function would result in net outlay savings of $1.7 billion in 1987, with savings totaling $17.7 billion over the 1987-1991 period.

SBA and FmHA Programs. Most of the savings in this function would result from the proposed elimination of the Small Business Administration (SBA) and the rural housing programs of the Farmers Home Administration (FmHA) beginning in 1987. Most of the FmHA assistance is provided by the Rural Housing Insurance Fund (RHIF) in the form of reduced interest rates for mortgage loans to low-income households or to developers of low-income rental housing. The President is proposing to reduce the 1986 program level to $1.3 billion, $700 million below the $2.0 billion currently authorized by the Congress, and to eliminate RHIF loans thereafter. Outlay savings would exceed $2 billion a year by 1989, and would total $9.9 billion over the 1987-1991 period.

To eliminate the Small Business Administration, as was proposed last year, the Administration would terminate the programs providing direct and guaranteed loans and equity investments, and sell the agency's portfolio over a four-year period. Certain SBA activities that provide advocacy, management, technical, and procurement assistance would be transferred to the Department of Commerce, to be funded at less than $40 million annually through 1991. Eliminating the agency would reduce outlays relative to the baseline by $0.7 billion beginning in 1987, with a cumulative savings of $6.1 billion over the five-year period.

HUD Programs. Currently, the Department of Housing and Urban Development (HUD) makes direct loans to nonprofit sponsors to finance construction of housing for low-income elderly or handicapped residents. The Administration's budget proposes to rescind virtually all of the more than $600 million authorized by the Congress for use in 1986 and to eliminate this program. Rental assistance payments would be provided by HUD to eligible households living in private housing.

At the time a mortgage loan guaranteed by the Federal Housing Administration (FHA) is closed, the borrower pays a fee typically amounting to 3.8 percent of the loan amount. Beginning in 1987, the President is proposing to increase the fee to 5.0 percent and to require that it be paid in cash. In addition, HUD intends to limit its insurance program to households with incomes no higher than $40,000. These proposals would increase government receipts by an estimated $1.5 billion through 1991.

The HUD budget also includes a proposed increase in the fees charged for mortgage-backed security guarantees. Fees would rise 9 basis points in 1987 and another 5 basis points in 1988. In total, this would increase fees from today's 6 basis points (0.06 percent) to 20 basis points (0.20 percent) in 1988. Income from such fees would reach $0.2 billion annually by 1990.

Postal Service. The President is proposing to increase by 2 percent annually the Postal Service payments to the Civil Service Retirement Fund. As a result, the Postal Service share of the actuarial costs of employee pensions would grow from the current level of 7 percent to 17 percent by 1991. Another proposal would require the Postal Service to begin paying the cost of postal annuitants' health benefit premiums beginning in 1987. These two changes would increase the costs of the Postal Service by about $0.7 billion in 1987, increasing to $1.5 billion by 1991. (These payments, totaling $6.4 billion over the five years, are intragovernmental transactions and would be reflected as offsetting receipts in other functions.) To recover these costs, the Postal Service would increase postal rates, resulting in net savings to the federal government over time.

The President is again proposing to eliminate the revenue forgone appropriation for the Postal Service. This payment compensates the Postal Service for revenues lost because the Congress has specified reduced postage rates for certain classes of mailers, primarily religious and other nonprofit organizations, blind and otherwise handicapped people, small-circulation newspapers, and libraries. Rather than continue taxpayer support for these subsidies, the President is proposing to eliminate eligibility for certain groups and maintain the subsidy for the remaining groups by increasing rates for other classes of mail. These changes would reduce appropriations by between $700 million and $800 million per year through 1991, but would increase the Postal Service deficit by similar amounts until the projected rate increase goes into effect in 1989. Because prior-year losses to the Postal Service are generally recovered over 10 years, the 1987 and 1988 reduction in the revenue forgone payment would not be fully recovered until 1999.

Assuming enactment of these proposals, CBO estimates that the price of first-class postage would increase to 26 cents in the second quarter of 1989, or 1 cent more than assumed in the CBO baseline. Such an increase would generate an additional $4 billion in revenue relative to the baseline in the 1989-1991 period. The combination of proposals affecting the Postal

Service would result in increased net spending in this function of $2.5 billion over the 1987-1991 period and increased receipts in other budget functions of $6.4 billion, for a net spending reduction of about $3.9 billion.

CBO Reestimates

Postal Service outlays exceed those estimated by the Administration by $1.0 billion in 1987 and $0.8 billion in 1988, but are lower in 1989 by $0.3 billion. In part, these adjustments reflect lower net income estimates of $1.0 billion in 1987 and $0.3 billion in 1988 resulting primarily from different productivity assumptions. Beginning in 1988, the Postal Service costs for increased health contributions were not included in the 1987 budget estimates. CBO has added about $500 million annually in 1988-1991 to reflect these expenses. These increases are partly offset by projected income of $0.8 billion in 1989, $0.6 billion in 1990, and $0.5 billion in 1991 resulting from CBO's assumptions about increased postal rates.

Because of the extent of the problems affecting financial institutions, outlays for the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC) insurance funds are expected to exceed the Administration's estimates by about $0.4 billion in 1987. CBO assumes that a special assessment will be imposed on thrift institutions to maintain the solvency of the FSLIC fund, resulting in net outlays about $0.2 billion to $0.4 billion less than those assumed by the Administration in 1988 and each year beyond.

CBO estimates of FHA Fund outlays exceed the Administration's by $0.3 billion in 1990 and $0.4 billion in 1991, because CBO estimates lower receipts and higher payments for insurance claims.

Credit Programs

Consistent with the President's proposal to terminate or curtail a number of commerce and housing programs, direct and guaranteed loans would be cut by about $19 billion and $59 billion, respectively, from 1987 through 1991. Most seriously affected would be FHA, SBA, and RHIF.

Beginning in 1987, SBA would no longer be providing, on an annual basis, direct financial assistance of about $750 million or guaranteed loans of about $3 billion. Loan assets totaling about $4.8 billion would be sold in 1987 through 1990. Offsetting the receipts from the sale of these assets is a loss of interest that otherwise would have been paid to the government. The reduction in interest receipts is reflected in budget function 900. These proposals are summarized in the table on the following page.

MAJOR CREDIT PROGRAM CHANGES PROPOSED FOR FUNCTION 370: COMMERCE AND HOUSING CREDIT (By fiscal year, in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
Direct Loan Obligations						
CBO Baseline	5.1	5.2	5.6	5.6	5.7	
Proposed Changes						
RHIF	-2.1	-2.2	-2.3	-2.4	-2.5	-11.5
Housing for Elderly	-0.6	-0.6	-0.7	-0.7	-0.8	-3.4
Small Business Administration						
Business	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
Federal Financing Bank Loans	-0.3	-0.7	-0.7	-0.7	-0.8	-3.2
Defaults	a/	a/	-0.2	-0.3	-0.4	-0.9
Government National Mortgage Association (Repurchases)	0.2	---	---	---	---	0.2
Other	---	---	a/	---	a/	0.1
Total	-2.9	-3.6	-4.0	-4.2	-4.5	-19.2
President's 1987 Budget as Estimated by CBO	2.2	1.6	1.7	1.4	1.2	
Guaranteed Loan Commitments						
CBO Baseline	40.5	42.2	43.8	45.6	47.4	
Proposed Changes						
Farmers Home Administration	-5.4	-6.9	-8.5	-10.2	-11.9	-42.9
SBA (Business)	-3.0	-3.1	-3.3	-3.4	-3.5	-16.3
Other	---	a/	a/	a/	a/	-0.2
Total	-8.4	-10.1	-11.8	-13.7	-15.5	-59.4
President's 1987 Budget as Estimated by CBO	32.1	32.1	32.0	31.9	31.9	

a. Less than $50 million.

FUNCTION 400: TRANSPORTATION

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 400: TRANSPORTATION (By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	27.4	27.4	28.1	28.8	29.6	
Proposed Changes						
Mass Transit	-0.7	-1.0	-1.4	-1.6	-2.2	-6.9
Federal-aid Highways	-0.2	-0.9	-1.3	-1.3	-1.8	-5.5
Amtrak	-0.6	-0.5	-0.6	-0.7	-0.7	-3.1
Grants-in-aid to Airports	a/	-0.2	-0.3	-0.4	-0.5	-1.4
Coast Guard Operations	0.2	0.2	0.2	0.2	0.2	1.0
Coast Guard User Fees	-0.2	-0.5	-0.5	-0.5	-0.5	-2.1
Ocean Freight Differential	-0.1	-0.2	-0.3	-0.3	-0.3	-1.2
Other	-0.2	a/	a/	a/	-0.1	-0.3
Total	-1.8	-3.0	-4.1	-4.7	-5.9	-19.5
President's 1987 Budget as Estimated by CBO	25.6	24.3	23.9	24.2	23.7	
President's 1987 Budget	25.5	24.1	23.4	23.7	23.1	
CBO Reestimates	0.1	0.2	0.5	0.5	0.6	1.9

a. Less than $50 million.

Proposed Policy Changes

The Administration is proposing to reduce transportation spending below the CBO baseline in all years, with total savings of almost $20 billion over the 1987-1991 period. The budget includes a 20 percent cut ($6.2 billion) from the baseline in 1987 budget authority, with first-year outlay savings of $1.8 billion.

Ground Transportation. Most of the outlay savings in this function would occur in ground transportation programs, with the largest reductions in mass transit. The Administration proposes to limit authorizations and obligations for transit programs to $1.2 billion annually, the amount that is generated by 1 cent of the 9-cent-per-gallon gasoline tax and earmarked for transit. This represents a decrease of $2.3 billion from the 1986 level. Of these funds, $1.1 billion would go to states as part of a new block grant proposal, and would be available for spending either on transit or highway projects. The remaining money would be spent on administration, research, and planning. Only small cities and rural areas would be able to use funds for operating assistance. In addition, the Administration would rescind over $500 million in contract authority in 1986 from funds earmarked for construction of new transit systems. Outlay savings in transit programs would total $6.9 billion over the 1987-1991 period.

The budget also includes reductions in the Federal-aid Highways program, reflecting the Administration's proposal for reauthorizing highway programs through 1990. Total obligations would be reduced from $13.2 billion in 1986 to $12.8 billion annually in 1987 through 1990, resulting in outlay savings of $5.5 billion over the five-year period. Annual budget authority for programs funded from the highway trust fund would be limited to estimated annual receipts, not including interest earned by the trust fund. The Administration proposes to create a $3.3 billion block grant program for states, using the $1.1 billion in transit funds mentioned above and $2.2 billion in highway funds. The highway portion of the grant comes from funds formerly earmarked for construction and rehabilitation of roads on the secondary and urban systems, as well as bridges not on the primary system.

The budget also includes five-year savings of $3.1 billion from eliminating all subsidies for Amtrak, which would reduce outlays by approximately $600 million per year. A similar proposal was made in last year's budget.

Air Transportation. The President's budget proposes only slight decreases in spending for aviation programs in 1987, but would reduce outlays by almost $1.5 billion over the five-year period. Most of the reductions would come from the grants-in-aid program for airport capital improvements. Under the President's budget, the obligation ceiling for airport grants would be reduced from $885 million in 1986 to $712 million in 1987, and then further reduced to $500 million annually in 1988 through 1991. Contract authority would also be reduced from the 1987 level of $1.0 billion (as authorized by Public Law 97-248), to $500 million per year in 1988 through 1991. Although spending for Federal Aviation Administration operations would be maintained at levels close to the baseline, the Administration proposes to derive 75 percent of the funds from the Airport and Airway Trust Fund, compared with only 16 percent in 1986.

Water Transportation. The budget reflects a net reduction of $2.5 billion in spending on water transportation from 1987 through 1991. As in previous budgets, the President is proposing user fees for certain Coast Guard services, yielding estimated receipts of $238 million in 1987 and a total of $2.1 billion over the 1987-1991 period. These savings would be partially offset by increases in Coast Guard operating expenses of about $0.2 billion annually, for capital investments and an increased emphasis on drug law enforcement and defense readiness activities.

The President is also proposing to terminate the new ocean freight differential program, which was established pursuant to the Food Security Act of 1985 (Public Law 99-198). The legislation increased from 50 percent to 75 percent the proportion of agricultural commodities shipped under certain programs that must be carried on U.S.-flag vessels. Termination of this expanded cargo preference requirement would result in estimated savings of $0.1 billion in 1987 and $1.2 billion over the 1987-1991 period.

CBO Reestimates

CBO estimates that spending under the Administration's proposed policy changes would be $1.9 billion higher over the five-year period than estimated in the budget. Much of this difference results from CBO's higher estimates of defaults on loans made by the Federal Ship Financing Fund (approximately $1 billion higher than the President's estimate over the five years). Other changes result from different spending rates, especially for aviation grants-in-aid and mass transit formula grants.

FUNCTION 450: COMMUNITY AND REGIONAL DEVELOPMENT

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 450: COMMUNITY AND REGIONAL DEVELOPMENT
(By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	7.7	7.8	8.0	8.0	8.2	
Proposed Changes						
Community Development Block Grants	a/	-0.2	-0.5	-0.6	-0.6	-1.9
Urban Development Action Grants	a/	-0.1	-0.2	-0.3	-0.3	-0.9
Other Community Development Programs	-0.2	-0.3	-0.3	-0.4	-0.4	-1.6
Rural Development Insurance Fund	-0.1	-0.2	-0.3	-0.4	-0.5	-1.5
Economic Development Assistance Programs	-0.1	-0.1	-0.2	-0.2	-0.2	-0.8
Other Regional Development Programs	a/	-0.2	-0.3	-0.5	-0.6	-1.6
Small Business Administration Disaster Loans	-0.7	-1.0	-1.0	-1.0	-0.5	-4.2
Other Disaster Programs	-0.3	-0.2	-0.2	-0.2	-0.2	-1.1
Total	-1.4	-2.4	-3.1	-3.5	-3.3	-13.7
President's 1987 Budget as Estimated by CBO	6.3	5.4	4.9	4.5	4.9	
President's 1987 Budget	6.5	5.5	5.0	5.2	5.2	
CBO Reestimates	-0.3	a/	-0.1	-0.7	-0.3	-1.3

a. Less than $50 million.

Proposed Policy Changes

As in previous budgets, the 1987 budget proposes major reductions in spending on community and regional development. Many of the programs within this function are proposed for elimination, while others are slated for large reductions. Total savings are estimated to be $13.7 billion over the 1987-1991 period, a reduction of about 35 percent in spending in this function. The President's proposals are based on the view that many of the benefits provided by these programs are local in nature, and, therefore, that the costs should be borne locally as well.

Community Development. About $4.4 billion of the five-year savings is in community development programs, which are aimed at urban areas. Funding for community development block grants (CDBGs) would be reduced by between $500 million and $600 million per year, beginning with a deferral of $500 million of 1986 budget authority. Urban development action grants (UDAGs) would be eliminated, beginning in 1987, after a rescission of $200 million of 1986 authority.

Rental housing development grants (HODAGs), rental rehabilitation grants, Section 312 rehabilitation loans, and CDBG Section 108 loans would also be eliminated in 1987. Partial rescissions of 1986 budget authority for some of these programs are also proposed, and reductions would be made in a number of smaller urban development programs. By 1991, community development spending would be 30 percent below CBO's baseline levels, and would consist almost entirely of community development block grants.

Regional Development. Over the 1987-1991 period, the President's budget would result in estimated savings of $3.9 billion in regional development programs, which are largely aimed at rural areas. Direct loan and loan guarantee activities of the Rural Development Insurance Fund (RDIF) would be terminated in 1987, and $100 million of the outstanding portfolio of direct loans would be sold to the public each year for five years. (This is part of a pilot program to determine the feasibility of such sales.) Economic Development Administration programs would also be eliminated, after a $100 million rescission of 1986 budget authority. The President is also proposing to eliminate rural water and waste disposal grants, the Appalachian Regional Commission and Appalachian regional development programs, and purchases of capital stock of the Rural Telephone Bank. New loan obligations by the Rural Telephone Bank would be phased out by fiscal year 1990, and spending would be reduced for the Tennessee Valley Authority, Bureau of Indian Affairs operations and construction programs, and many smaller programs. A rescission of about $80 million of fiscal year 1986 budget authority for Appalachian regional development is also proposed. By 1991, regional development outlays would be 45 percent below baseline levels.

Disaster Relief and Insurance. The President's proposals would reduce disaster assistance by $5.3 billion over the 1987-1991 period. Under the President's proposed budget, the Small Business Administration (SBA) would make no new disaster loans beginning in 1987, and the outstanding portfolio would be sold over four years. Outstanding loans would be administered by the Department of the Treasury, and the receipts from loan sales, as well as the repayments on the outstanding unsold portfolio, would accrue to the Treasury. The budget also includes proposals to raise flood insurance premiums in 1986 and 1987 and to increase the share of disaster costs expected to be borne by state and local governments. The flood plain management program would be funded from flood insurance premiums, and the U.S. Fire Administration would be eliminated.

CBO Reestimates

The roughly $700 million difference in fiscal year 1990 is primarily attributable to CBO's much higher estimate of receipts from the sale of SBA disaster loans. Otherwise, CBO's outlay estimates do not differ significantly from the Administration's estimates for this function.

Credit Programs

The CBO baseline projects direct loan obligations of $2.4 billion in 1991, largely for SBA disaster loans and rural development loans of the RDIF. As shown in the table on the following page, the President is proposing to end virtually all lending activity in this function.

MAJOR CREDIT PROGRAM CHANGES PROPOSED FOR FUNCTION 450: COMMUNITY AND REGIONAL DEVELOPMENT

(By fiscal year, in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
			Direct Loan Obligations			
CBO Baseline	1.7	2.3	2.2	2.3	2.4	10.9
Proposed Changes						
Rural Development Insurance Fund	-0.4	-0.5	-0.5	-0.5	-0.5	-2.4
Rural Telephone Bank	a/	-0.1	-0.2	-0.2	-0.2	-0.7
Small Business Administration (Disaster Loans)	-0.7	-1.1	-1.1	-1.1	-1.2	-5.2
Community Development Block Grant (Section 108)	-0.2	-0.2	-0.2	-0.2	-0.2	-0.8
Other	a/	a/	a/	-0.3	-0.3	-0.6
Total	-1.3	-1.9	-2.0	-2.3	-2.4	-9.7
President's 1987 Budget as Estimated by CBO	0.4	0.4	0.2	a/	a/	1.2

a. Less than $50 million.

FUNCTION 500: EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 500: EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES
(By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	30.9	32.2	33.4	34.8	36.3	
Proposed Changes						
Elementary and Secondary Education	-0.4	-0.8	-1.3	-1.9	-2.4	-6.8
Higher Education						
Student Aid	-0.6	-1.4	-1.7	-2.0	-2.4	-8.2
Guaranteed Student Loans	-0.8	-1.1	-1.7	-1.8	-1.8	-7.2
College Housing	-0.6	-0.4	a/	a/	a/	-1.0
Other Education	-0.1	-0.4	-0.5	-0.7	-0.7	-2.4
Training and Employment	-0.6	-0.8	-1.1	-1.4	-1.8	-5.7
Social Services	-0.5	-0.8	-1.0	-1.2	-1.5	-5.0
Total	-3.6	-5.7	-7.4	-9.0	-10.6	-36.3
President's 1987 Budget as Estimated by CBO	27.3	26.5	26.0	25.7	25.7	
President's 1987 Budget	27.4	26.3	26.4	26.0	26.0	
CBO Reestimates	-0.1	0.1	-0.5	-0.3	-0.3	-1.0

a. Less than $50 million.

Proposed Policy Changes

The Administration proposes major reductions in federal funding for education, training, employment, and social service programs. In 1987, spending would be reduced by $3.6 billion or 12 percent below CBO's baseline. By 1991, spending would be reduced $10.6 billion or about one-third. Proposed changes include 1986 rescissions totaling $1.8 billion and proposals to eliminate or substantially reduce many of the major programs in this function. No major programs are increased in the President's request.

Elementary and Secondary Education. The President proposes rescinding $330 million in funding for elementary and secondary education grant programs in 1986 and reducing spending by 5 percent in 1987 and 25 percent in 1991. The Administration's request maintains funding for disadvantaged students at or near 1986 levels, and, as a result, elementary and secondary education grants are reduced by somewhat less than the average reduction in the function.

Higher Education. The Administration proposes major reforms and reductions for higher education programs, which would require many families and students to increase their financial commitment to higher education. Only the neediest students would continue to receive their current levels of federal assistance. Under the Administration's request, federal spending for student aid grants and guaranteed student loans would be reduced by 17 percent in 1987 and 44 percent in 1991.

In 1986, $450 million in student aid grants is proposed for rescission. In addition, the President proposes to reduce the Pell grant program by 17 percent in 1987 and 35 percent in 1991. Expected contributions from the family would be increased, and benefits would be targeted toward students from families with incomes below $23,000. Remaining student aid grants would be eliminated, restructured, or reduced.

The President is requesting 20 major and other minor changes to the Guaranteed Student Loan (GSL) program. These changes would reduce the number of eligible students and federal subsidies to those students. They would also reduce yields to lenders and reduce payments to state guarantee agencies. Spending in 1987 would decline by 22 percent and in 1991 by 60 percent.

The specific changes proposed in the GSL program include a revised financial needs test that would further target program eligibility. Over 1 million students—about 25 percent of current borrowers—would have their loan levels reduced or eliminated from the subsidized regular GSL program as a result of the more restrictive financial needs test. In-school interest subsidies would also be eliminated; students eligible for a loan would be required to pay all the interest on the loan, which would be made at a market rate of interest. Loan limits would be increased to cover the cost of interest payments. The current 5 percent origination fee would continue to be collected, but it would be used as an insurance fee against default. The present supplemental loan program for parents and independent students would be expanded to include all students, and the federal interest subsidies on those loans would be eliminated by charging borrowers a market rate of interest. The borrowers in this supplemental loan program would be charged a 1 percent insurance fee against default. Yields to private lenders would be changed from a variable rate tied quarterly to the 91-day Treasury bill rate to a lower-yielding fixed rate. Private lenders and state guarantee agencies would be required to pay at least 10 percent of default claims on future loans, and state agencies would no longer receive an administrative allowance.

The President also proposes selling $2.1 billion in college housing loans to private investors during 1987 and 1988. These loan assets would be sold at a discount and are estimated to yield about $1.0 billion. The federal government would lose approximately $2.6 billion in the receipts from these loans over the next 20 years.

Other Education. Other education activities, which currently account for $2 billion of spending in this function, would be reduced by 7 percent in 1987 and by one-third in 1991. In 1986, $250 million in grants is proposed for rescission. In 1987 and beyond, reductions result from the elimination of funding for libraries, public telecommunication, and museum services. The amount of institutional aid given to colleges would be reduced by 45 percent, and most of the remaining programs would be maintained at or near their 1986 levels.

Training and Employment. Under the President's proposals, baseline spending for training and employment programs would decline by 12 percent in 1987 and 29 percent by 1991. In 1986, $450 million in grants are proposed for rescission. Basic training grants would be funded at or near 1986 levels throughout the period 1987-1991. Funding for summer youth employment, job corps, and assistance for dislocated workers would be reduced by between 50 percent and 60 percent over the projection period. In addition, the Work Incentive (WIN) program would be eliminated; work requirements would be picked up under the Aid to Families with Dependent Children program with 50 percent federal matching rates.

Social Services. The Administration proposes reducing current spending of $7.4 billion for social service programs by 7 percent in 1987 and 17 percent in 1991. In 1986, rescissions would total $300 million. In 1987 and the outyears, funding for the community services block grant would be eliminated, and grants for vocational rehabilitation programs would be reduced 9 percent in 1987 and 23 percent by 1991. Funding of the foster care program would be fixed at its 1984 level adjusted by changes in the Consumer Price Index (CPI), and the remaining social service programs would be funded at or near their 1986 levels.

CBO Reestimates

Most of the CBO reestimate of the President's budget in this function occurs in the GSL program. CBO projects lower loan volume and related budget costs including interest subsidies and default costs.

Credit Programs

Direct Loan Obligations. The President proposes to reduce direct loan obligations under this function by $700 million over the next five years. In the GSL program, federal default claim payments are considered direct loans of the federal government. The President has proposed two major GSL program changes that would result in lower federal default payments. First, program eligibility and thus loan volume would be reduced by requiring a more restrictive financial needs test. Second, private lenders and state guarantee agencies would be required to assume responsibility for at least 10 percent of future default claims, thus lowering federal default payments. In 1991, federal default payments would be reduced by an estimated $225 million.

The President has also proposed to rescind the 1986 loan obligation authority of $57 million for the college housing program and to terminate the authority in the out-years. In addition, the President proposes to sell existing loans to private investors.

As part of its student aid reform package, the Administration has proposed establishing a new, unsubsidized direct loan program to replace the National Direct Student Loan (NDSL) program. This proposed income-contingent loan program would allow borrower repayments to vary with earnings after school. The President proposes to finance this new program at higher levels than the current NDSL program contribution rate.

Guaranteed Loan Commitments. The Administration's request for the GSL program includes several reforms that would lower new guaranteed loan volume under the subsidized regular loan program and would also transfer some of the volume to the proposed unsubsidized supplemental program. These changes would reduce new guarantees by $1.4 billion over the next five years.

As a result of the more restrictive needs test and reduced interest subsidies in the GSL program, loan volume would decrease an estimated $1.6 billion in 1987 and by larger amounts in the out-years. This reduction of loan volume would be partially offset by allowing eligible students to increase their borrowing to cover the cost of interest while they are in school. Also, students made ineligible by the proposed needs test in the regular program could transfer to the supplemental loan program.

MAJOR CREDIT PROGRAM CHANGES PROPOSED FOR FUNCTION 500: EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES

(By fiscal year, in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
			Direct Loan Obligations			
CBO Baseline	1.5	1.5	1.5	1.4	1.4	
Proposed Changes						
Guaranteed Student Loans	a/	-0.1	-0.2	-0.2	-0.2	-0.6
College Housing	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3
Income-contingent Loans	a/	a/	0.1	0.1	0.1	0.3
Total	-0.1	-0.1	-0.2	-0.2	-0.2	-0.7
President's 1987 Budget as Estimated by CBO	1.5	1.4	1.3	1.2	1.2	
			Guaranteed Loan Commitments			
CBO Baseline	10.5	10.7	10.9	11.1	11.3	
Proposed Changes						
Guaranteed Student Loans						
Regular	-1.1	-0.9	-1.0	-0.9	-0.9	-4.7
Supplemental	0.1	0.5	0.9	0.9	0.9	3.3
Total	-1.0	-0.4	-0.1	a/	a/	-1.4
President's 1987 Budget as Estimated by CBO	9.6	10.3	10.8	11.1	11.3	

a. Less than $50 million.

FUNCTION 550: HEALTH

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 550: HEALTH (By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	38.5	40.9	43.2	46.0	48.9	
Proposed Changes						
Medicaid	-1.3	-1.8	-2.0	-2.3	-2.6	-10.0
Federal Employees Health Benefits	-1.2	-0.7	-0.8	-1.0	-1.2	-4.9
Public Health Service	-0.7	-1.2	-1.8	-2.3	-2.8	-8.8
Other	-0.3	-0.3	-0.4	-0.4	-0.4	-1.9
Total	-3.5	-4.0	-4.9	-5.9	-7.1	-25.4
President's 1987 Budget as Estimated by CBO	35.1	36.8	38.3	40.0	41.8	
President's 1987 Budget	35.0	36.7	37.9	39.4	40.7	
CBO Reestimates	0.1	0.2	0.4	0.7	1.1	2.4

Proposed Policy Changes

The President proposes to reduce health spending sharply, primarily by actions similar to those proposed in last year's budget. Nearly half of the savings would come from legislative changes proposed in Medicaid, the largest program in this function. The reductions in Medicaid spending would be between 5 percent and 8 percent in each year over the five-year projection period. The President's budget also proposes to reform the Federal Employees Health Benefits (FEHB) program, cutting federal costs by one-third by 1991, and to freeze funding for the Public Health Service for five years, a reduction of one-quarter by 1991.

Medicaid. The Administration proposes to reduce Medicaid payments in 1987 by capping the federal reimbursement at $1.3 billion below estimated current law spending. A $0.3 billion hardship fund would be available in 1987 to help states adjust to these cutbacks. In addition, the President's budget proposes a single match rate of 50 percent for state and local administrative costs, which would eliminate higher special matching rates. In 1987, this would save an additional $0.3 billion. After 1987, the federal cap would grow by the increase in the medical care component of the CPI. A similar proposal was made last year.

States would also be required to seek third-party reimbursements, reform prescription drug reimbursement, and require second surgical opinion and inpatient hospital preadmission review programs. These changes would not add to Medicaid savings because of the program cap.

Federal Employees Health Benefits. The Administration is again proposing to replace the formula by which the government contribution for health insurance premiums is determined with a fixed dollar amount that would be adjusted each year by the change in the implicit price deflator for the gross national product (GNP). The current 75 percent limit on government contributions for insurance premiums would be dropped, and enrollees could receive rebates of up to 40 percent of the government contribution if they selected plans costing less than the fixed government payment. The Administration also proposes to have the U.S. Postal Service and the District of Columbia pay the total government share of their employees' health insurance, and to discontinue payments to insurance companies from the Employees Health Benefits contingency reserves. Finally, the Administration would require insurance companies to return their excess reserves to the federal government in 1987.

Public Health Service. Funding for the Public Health Service is frozen through 1991 at a level slightly below the 1986 level. Half of the savings would result from a freeze on research funding for the National Institutes of Health (NIH). The President's proposal would maintain 18,000 NIH research grants in each year, about 800 fewer grants than were supported by the 1986 appropriation. Rescissions are requested in 1986 for NIH in order to reach the proposed grant level by 1987.

The President's budget would rescind more than $0.4 billion in 1986, including funds for NIH, from funds appropriated for the Public Health Service. The Administration also proposes to eliminate health professions education and training programs in 1987 as well as funding for construction of Indian health facilities.

Other. In other health-related areas, the Administration proposes to charge fees for services provided by the Food Safety and Inspection Service (FSIS). Fees would be set to recover the full cost of FSIS activities, thereby reducing outlays in the President's budget by $0.3 billion to $0.4 billion below the CBO baseline in each year.

CBO Reestimates

CBO has reestimated upward the President's budget for the Medicaid program by $2.4 billion over the five years. CBO projects higher price increases for medical care than does the Administration. Since the Administration proposes to limit Medicaid growth by the growth in the medical care component of the CPI, CBO projects larger Medicaid spending.

FUNCTION 570: MEDICARE

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 570: MEDICARE (By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	75.3	84.6	94.8	106.2	119.0	
Proposed Changes						
Beneficiary Costs						
SMI Premiums	-0.9	-2.0	-3.4	-5.0	-6.8	-18.0
Private Coverage for Aged and Disabled	-0.5	-0.6	-0.7	-0.8	-0.9	-3.4
Deductible	-0.3	-0.4	-0.5	-0.6	-0.7	-2.4
Eligibility	-0.2	-0.3	-0.3	-0.4	-0.4	-1.6
Home Health Copayment	-0.1	-0.1	-0.1	-0.1	-0.2	-0.6
Subtotal	-1.9	-3.4	-5.0	-6.8	-8.9	-26.0
Hospital Reimbursements						
Capital	-0.4	-1.4	-1.9	-2.8	-3.5	-10.1
Medical Education						
Indirect costs	-1.4	-1.8	-2.0	-2.2	-2.4	-9.8
Direct costs	-0.4	-0.5	-0.6	-0.7	-0.8	-3.0
Interaction	0.0	0.1	0.1	0.2	0.2	0.6
Subtotal	-2.2	-3.7	-4.4	-5.5	-6.5	-22.2
Reimbursements to Other Providers						
Physicians	-0.4	-0.5	-0.6	-0.6	-0.7	-2.9
Other	-0.1	-0.2	-0.3	-0.5	-0.6	-1.7
Subtotal	-0.5	-0.7	-0.9	-1.1	-1.3	-4.6
Total	-4.7	-7.8	-10.3	-13.4	-16.7	-52.8
President's 1987 Budget as Estimated by CBO	70.6	76.9	84.5	92.8	102.3	
President's 1987 Budget	70.2	76.0	83.0	90.5	98.4	
CBO Reestimates	0.4	0.8	1.4	2.3	3.9	8.9

Proposed Policy Changes

The President proposes a number of changes in Medicare that would reduce spending relative to the CBO baseline by $4.7 billion in 1987 and $52.8 billion over the projection period. Many of the proposals have been included in similar forms in previous budgets. The 1987 budget, however, includes a major new initiative to reimburse hospitals for capital costs.

Almost half of the federal savings would come from proposals to increase the costs paid by beneficiaries or their insurance companies. Another 43 percent of the savings would be achieved by reducing reimbursements to hospitals. The remaining savings would result from reducing reimbursements to physicians, laboratories, or other providers of medical services.

Beneficiary Costs. Out-of-pocket costs to beneficiaries would be increased significantly through proposed increases in the SMI premiums. The President's proposal would establish separate premiums for individuals and third-party payers, thereby saving $18 billion over five years. A related proposal has been included in previous budgets.

For individuals, the premium would be gradually increased over the next five years from 25 percent to 35 percent of program costs. For calendar year 1987, for example, the monthly premium would be increased by $1.40 above the baseline premium of $18.10.

For third-party payers who buy Medicare Part B coverage, the premiums would be set at 50 percent of costs. This proposal would have the greatest impact on the states that pay the Medicare premium for their Medicaid beneficiaries. For calendar year 1987, the monthly premium paid by third-party payers would be doubled. The projected monthly baseline premium in 1991 of $21.30 would be increased to $38.50 for individuals and to $54.90 for third-party payers.

The Administration also proposes to require employers to offer the same insurance coverage to employees over age 69 that they provide to other employees. The Congress recently enacted legislation to require such coverage for employees aged 65 through 69. The proposal would make Medicare the secondary payer for any worker choosing to accept the insurance coverage offered by his or her employer. The same opportunity for insurance coverage would also be required for disabled or aged beneficiaries who have access to health insurance coverage through their spouse's employer. Over one-half of the $3.4 billion five-year savings would be achieved by changing the insurance coverage of the disabled.

The President again proposes raising the Medicare Part B deductible from $75 to $100 effective January 1, 1987, and indexing the deductible to annual changes in the Medicare Economic Index (MEI) thereafter. The deductible would be rounded to the nearest whole dollar. The estimated deductible under this proposal for 1987 through 1991, respectively, would be $100, $103, $107, $111, and $115.

The other proposed changes that would increase beneficiary costs have also been included in past Administration budgets. Eligibility for Medicare would be delayed by one full month, saving $1.6 billion over the projection period. Beneficiaries who have not been hospitalized but use home health care would be required to make a per-visit copayment of 1 percent of the hospital deductible (or about $5 per visit in 1987).

Hospital Reimbursements. The President's budget includes several proposals to reduce reimbursements to hospitals, saving $22.2 billion over the next five years. Almost one-half of these savings would result from the Administration's proposal, through regulation, to phase capital reimbursement into a national rate per admission by 1991. The Administration would also disallow reimbursement for return-on-equity payments and would change the treatment of interest earned on funded depreciation. This change would be phased in by 1990. CBO estimates that the proposal affecting capital would reduce reimbursements to hospitals by over 40 percent in 1991. CBO's savings estimates for this proposal are smaller than the Administration's because of CBO's lower projected growth rates in Medicare capital reimbursements.

The Administration would also reduce Medicare's reimbursement for both the direct and indirect costs of medical education. These changes require both legislative and regulatory action and would produce savings of $12.8 billion over five years. The change in direct medical reimbursements would eliminate payments for allied health professionals, nursing training programs, and classroom-related expenses for residency programs. Hospital-specific limits on residency expenditures would also be set. The change in indirect payments would alter the formula for reimbursement and would cut the indirect teaching adjustment in half. CBO's estimates of savings from the indirect proposals are higher than the Administration's because of higher growth rate assumptions in hospital spending and therefore higher indirect medical education add-on costs.

The proposed reform in capital reimbursement interacts with the proposal to reduce reimbursement for indirect education. Indirect education costs are calculated as a function of prospective payments. Including capital in prospective payment rates would thus increase reimbursements for indirect education. This interaction would reduce the savings from enacting both proposals by $0.6 billion over the projection period.

Reimbursements to Other Providers. Various proposals to reduce reimbursements to physicians, laboratories, and other providers of medical services would save an estimated $4.6 billion over the 1987-1991 period.

Five proposals would affect reimbursements to physicians. Payments for selected physician procedures would be reduced where technological and productivity advances, or geographic variations, indicate a cost below existing Medicare rates. Payments would be limited both to physicians who furnish standby anesthesia services and to those who provide unnecessary assistants at surgery. Lens replacements after cataract surgery would be reduced by adopting criteria that would ensure medical necessity, and excessive payments for lens replacements would be reduced. Finally, the MEI would be recomputed for past years using a "rental equivalence" measure of housing prices in the Consumer Price Index, which forms part of the MEI.

The Administration also proposes to freeze, during 1987, Medicare's reimbursement for laboratory services performed in clinical laboratories, physicians' offices, and in hospital out-patient departments; to revise payment rates for end-stage renal disease treatments where recent data indicate that payments may be too high; and to eliminate payments to providers for services not covered under Medicare for which a partial payment is currently made.

CBO Reestimates

CBO projects higher growth in baseline spending for Medicare than does the Administration, primarily for the Hospital Insurance program. CBO's projected payments to hospitals under the prospective payment system (PPS) show higher growth for both economic and technical reasons. The prices of goods and services in the hospital market basket used to determine hospital payments are higher in 1990 and 1991 under CBO's assumptions. Also, reflecting a continuation of recent trends, CBO projects somewhat larger changes in the mix of cases toward those with higher payment rates. By 1991, the CBO projections are about 3 percent above those of the Administration.

FUNCTION 600: INCOME SECURITY

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 600: INCOME SECURITY (By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	124.1	130.6	135.2	140.5	148.2	
Proposed Changes						
Retirement and Disability						
Civil Service	-0.6	-1.3	-1.9	-2.5	-3.3	-9.6
Military and Other	-0.5	-0.7	-0.8	-0.9	-0.9	-3.8
Housing Assistance	-2.1	-3.2	-3.6	-4.0	-4.1	-17.0
Nutrition	-0.9	-1.1	-1.2	-1.3	-1.5	-5.9
Aid to Families with Dependent Children	-0.1	-0.2	-0.2	-0.2	-0.2	-0.7
Food Stamps	-0.2	-0.3	-0.4	-0.5	-0.5	-1.9
Pension Benefit Guaranty Corporation	-0.2	-0.2	-0.1	-0.1	-0.1	-0.7
Low-Income Energy	0.2	0.1	0.1	a/	-0.1	0.2
Refugee Assistance	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4
Other	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4
Total	-4.6	-6.9	-8.3	-9.6	-10.8	-40.1
President's 1987 Budget as Estimated by CBO	119.5	123.7	127.0	130.9	137.4	
President's 1987 Budget	118.4	123.1	125.7	128.3	132.5	
CBO Reestimates	1.1	0.5	1.2	2.6	4.9	10.4

Proposed Policy Changes

The President's proposals in income security would reduce outlays below CBO's baseline by 7 percent in 1991 and would save $40.1 billion over the 1987-1991 period. Several of the President's major policy themes are evident in the income security cuts. The Administration proposes to reduce retirement and disability benefits of government employees to, in its view, make them more comparable with private-sector benefits. The budget also proposes to curtail housing assistance by almost 25 percent, and shift to vouchers, to encourage privatization. Programs for low- and moderate-income families would be affected in several ways. Benefits from child nutrition programs would be targeted more toward lower-income families by abolishing the subsidies to families with incomes above 185 percent of the poverty threshold. Work requirements would be strengthened in Aid to Families with Dependent Children and in Food Stamps.

Retirement and Disability. The President proposes several changes for retirement and disability programs, many of which have appeared in several of his previous years' budgets. The Congress spent much of last year working on legislation to create a new retirement system for federal employees hired after 1984, but adopted none of the President's proposed changes to the current retirement system. There also were no legislative changes in the military or railroad retirement programs. In fact, the only reduction in these programs that would occur as a result of legislative action last year is the elimination of the cost-of-living adjustments (COLAs) for 1986 under the sequestration provisions of the Balanced Budget Act.

This year the President again proposes to limit COLAs, which accounts for 90 percent of the savings proposed in retirement and disability programs. COLAs would be eliminated in 1987 for military retirees and rail industry pensioners. The COLA would also be eliminated in 1987 for Civil Service and Foreign Service retirees and, in addition, their benefits would be increased in future years by 2 percentage points less than the Consumer Price Index (CPI). By 1991, Civil Service Retirement benefits would be 10 percent lower under this proposal than under current law.

Other proposals in Civil Service Retirement would reduce benefits for early retirement, change the basis on which benefits are calculated from the highest three years of salary to the highest five years, and change certain benefits to conform with treatment of similar benefits in Social Security. These latter two changes would also apply to Foreign Service Retirement.

In addition to the proposed outlay reductions in Civil Service Retirement, the President's budget proposes an increase of 2 percentage points in agency and employee contributions for retirement. The U.S. Postal Service and the District of Columbia would also be required to pay the full government share of their employees' retirement benefits. These changes would increase trust fund balances, but would have no effect on retirement outlays.

The Administration also proposes to reclassify certain Railroad Retirement beneficiaries so that they would receive the lower rail industry pension COLA instead of the Social Security COLA they currently receive. The President also proposes reducing the federal subsidy for windfall benefits received by some railroad retirees. The reduced federal subsidy would be covered by increased rail industry contributions.

Benefits in the Black Lung and Special Benefits for Disabled Coal Miners programs are indexed to changes in federal pay. The President proposes to limit federal pay increases to 3 percent in each year, lowering outlays in the two disability programs below the CBO baseline.

Housing Assistance. The President's budget would cut housing assistance sharply from current levels. For fiscal year 1986, the Congress has appropriated over $9.8 billion for the Department of Housing and Urban Development's (HUD) rental assistance and public housing programs. After the reductions required by the Balanced Budget Act, this amount is estimated to be sufficient to assist about 93,000 additional housing units, over 11,000 of which would be newly built units intended for elderly or handicapped households. Also included was funding for about 6,500 public housing units and $1.4 billion for modernizing existing public housing projects. The CBO baseline is based on the 1986 appropriation act and includes the amounts estimated to be necessary to provide for 93,000 additional units in each year.

The Administration's budget proposes that newly assisted units be limited to 50,000 per year starting in 1986. The budget also assumes that these subsidies would be in the form of five-year vouchers rather than the more traditional 15- to 20-year rental assistance contracts. No additional funding would be provided for the elderly, handicapped, or public housing construction programs. In addition to these changes, the President has proposed a one-year freeze on rent increases for much of the assisted housing inventory. Annual rent adjustments to allow for cost increases would resume in 1988. In order to further reduce program costs, HUD intends to reduce sharply the administrative fees paid to public housing authorities. It is anticipated that local governments would offset the lower federal payments. Together, these cuts would total $13.8 billion over five years.

The President's budget would also cut spending of the Public Housing Loan Fund, by a five-year total of $2.2 billion. New public housing construction would be eliminated. The modernization of existing projects, however, would continue. It is proposed that this activity be financed with federal grants rather than with the long-term direct loans now used. Since, under existing procedures, HUD provides both the direct loans and the payments necessary to amortize the loans, this proposal would have no effect on overall program costs. The Administration's budget includes limited modernization funding for 1986 and 1987, but assumes increased spending in 1988 through 1991.

Finally, public housing operating subsidies and other assistance would be cut by $0.9 billion over five years. The Administration proposes a reduction in operating subsidies in 1987, with moderate increases in later years, while CBO's baseline is based on the 1986 level, adjusted for inflation.

Nutrition Programs. The Administration's major proposal to reduce nutrition programs is to eliminate cash and commodity subsidies to children from families with incomes above 185 percent of the poverty level. In addition to this proposal, which was also included in last year's budget, the Administration proposes capping extra payments for breakfasts and lunches served in schools designated in "severe need," lowering summer food rates to be comparable with rates in schools and child care centers, eliminating the Nutrition Education and Training program, and eliminating administrative funding for child care audits.

Eliminating subsidies to children from families with incomes above 185 percent of the poverty level is estimated to save a five-year total of $4.5 billion. Subsidies would be eliminated for approximately 50 percent of the lunches and 10 percent of the breakfasts served in schools, 25 percent of the meals served in child care centers, 65 percent of the meals served in family day care homes, and 95 percent of the half-pints of milk served under the Special Milk program. Total program spending would be cut less dramatically because the per-meal subsidy is lower for the eliminated subsidies than for the remaining subsidies to children from low- and moderate-income families.

Although the proposal would not directly cut subsidies to families with incomes below 185 percent of poverty, some children from lower-income families would be affected if the schools they attend were to drop out of the program. The Administration assumes that no schools would discontinue the program and thus is showing slightly lower savings than CBO, which assumes some schools would drop out.

The Administration also proposes eliminating the Emergency Food Distribution and Shelter program, saving $0.4 billion over five years. The Nutrition Assistance program in Puerto Rico would receive a flat grant of $825 million annually, which is $0.4 billion below the baseline levels for 1987 through 1991. Proposed funding for the Supplemental Food Program for Women, Infants, and Children (WIC) equals CBO's baseline in 1987, but would save $0.2 billion over the next four years through small caseload reductions.

Aid to Families with Dependent Children (AFDC). The most far-reaching AFDC proposal in the President's budget would require most employable AFDC recipients to participate in a work-related activity, such as job search or workfare. CBO's estimate of the proposal shows costs to exceed savings in AFDC, while the Administration's estimate shows savings to exceed costs. Studies of job search programs, which often entail two to six weeks of search, have found them to save money on balance. The first adequate evidence on workfare programs should become available shortly, but until then their cost effectiveness is uncertain. Moreover, existing state workfare programs typically require participants to remain in workfare for only a few months, whereas the Administration's proposal would require continual participation for many AFDC recipients, adding to the proposal's cost. The proposal also generates sizable savings in Medicaid, which would more than offset CBO's estimated costs in AFDC. However, because the President's budget proposes a cap on the Medicaid program, these potential savings would not be realized by the federal government.

Other AFDC proposals, like work requirements, have in most cases been proposed before. These proposals would require that most mothers under 18 years of age live with their parents; remove an employable adult's benefits when the youngest child reaches age 16; and tighten the definition of an "essential" person. Together these proposals would save an estimated $125 million a year and affect about 175,000 families. In addition, matching rates on costs from automatic data processing systems would be reduced to 50 percent by 1990 and thereafter from the current 90 percent. Matching rates would also be reduced for a few states with administrative costs per recipient that are greater than 175 percent of the U.S. median.

Food Stamps. The President's budget proposes to reduce Food Stamp spending by repealing the program expansions authorized under the recently enacted Food Security Act of 1985. The repeal of increases in the asset limitation and in the earned income, dependent care, and shelter deductions, which are scheduled to occur May 1, 1986, is estimated to save less than $0.1 billion in 1986 and $1.2 billion over the following five years. The budget also proposes to eliminate some overlap of benefits between the Food Stamp Program and assistance received under the Low-Income Home Energy Assistance Act and the Job Training Partnership Act. These two proposals, considered but rejected during last year's farm bill debate, would together save an estimated $0.4 billion over five years.

The Administration would also modify the employment and training program authorized last December by increasing the percentage of work registrants required to participate to 25 percent in 1987, 50 percent in 1988, and 75 percent in 1989; adding an additional requirement of universal job search upon application; and reducing the federal share of administrative costs. CBO estimates that savings in the work program would be $0.1 billion annually. Lack of certainty about how either the existing program or the proposed program would be implemented make this estimate quite tentative. The budget also proposes to increase fiscal sanctions for states with high error rates. Based on the difficulty in collecting fiscal sanctions thus far, CBO estimates that the proposed 1987 sanctions would not be collected until 1990.

Pension Benefit Guaranty Corporation (PBGC). The President's budget proposes an increase in the PBGC premium for the single employer plan from $2.60 to $8.10 per employee per year. This proposal has appeared in several previous budgets. The CBO estimate of savings from the premium increase is significantly lower in the out-years than the Administration's because CBO assumes that the additional premiums would merely partially substitute for other receipts (transfers from trust funds).

Low-Income Energy Assistance. In the President's budget, the energy assistance program for low-income households would be funded at $2.1 billion through 1991. The CBO baseline is below this level in 1987 through 1989 because it reflects falling energy prices in the near term. Thus, the program would show costs through 1989 followed by savings in later years.

Refugee and Entrant Assistance. The Administration is proposing, beginning in 1987, that refugees become ineligible for AFDC and Medicaid and instead become eligible for yet-to-be-proposed cash and medical assistance under the refugee program. While this proposal increases budget authority for the refugee program, a corresponding decrease in budget authority would occur in AFDC and Medicaid. In addition, the Administration is proposing that refugees receive assistance only for the first 18 months after arriving in the United States, rather than for 36 months as under current law. After the first 18 months, refugees could become eligible for AFDC and Medicaid, but the states would not be reimbursed for their share of these costs.

Other. Other proposed changes in income security include those in Supplemental Security Income (SSI), Child Support Enforcement (CSE), and in the Department of Health and Human Services' management and research activities. The President's budget carries savings of $34 million a year in SSI. Because the proposed changes have not yet been specified, however, CBO shows no savings. In CSE, the lower federal match rate required under the Balanced Budget Act would be continued, and the match rate on automatic data processing would be reduced, leading to savings of $0.1 billion over the five-year period. In general departmental management, policy research, and the Office of the Inspector General, the President's budget requests constant budget authority throughout the 1987-1991 period, resulting in cumulative five-year savings of $0.3 billion compared to CBO's baseline.

CBO Reestimates

CBO reestimates raise the President's budget by $10.4 billion over the five-year period. More than three-quarters of the reestimate reflects different economic assumptions--mainly CBO's higher prices and thus COLAs but also CBO's higher unemployment rates. Technical reestimates total $2.3 billion over the period and are the net of many upward and downward reestimates in the various income security programs. The larger income security programs are entitlements, and the technical reestimates usually reflect differences either in projected numbers of beneficiaries or in average benefit levels per beneficiary, or in both.

FUNCTION 650: SOCIAL SECURITY

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 650: SOCIAL SECURITY (By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	211.6	226.3	241.7	258.2	275.9	
Proposed Changes						
Administrative costs	0.1	-0.1	-0.2	-0.3	-0.4	-0.9
Total	0.1	-0.1	-0.2	-0.3	-0.4	-0.9
President's 1987 Budget as Estimated by CBO	211.6	226.2	241.5	257.9	275.5	
President's 1987 Budget	212.2	226.1	239.9	254.7	263.5	
CBO Reestimates	-0.6	0.1	1.6	3.2	12.0	16.4

Proposed Policy Changes

The President proposes no changes to Social Security cash benefits, but resubmits the proposal in last year's budget to reduce the number of Social Security Administration (SSA) employees to 63,000 by 1990--a reduction of 17,000 from the fiscal year 1984 level. This initiative, combined with a freeze in other administrative costs, would save about $0.9 billion over the next five years. On the other hand, the President's 1987 request for SSA administrative expenses is about $73 million higher in the Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI) programs than is assumed in the CBO baseline. In essence, the President's request for 1987 administrative expenses would restore much of the base reduction that occurred from the 1986 sequestration.

The Administration proposes these staffing reductions because of increases in productivity arising from the systems modernization program now under way at SSA. It is uncertain what the magnitude of these productivity increases might be. Last year the Congress appropriated more funds than the President had requested specifically to ensure that the proposed staffing reduction would not be undertaken so quickly as to jeopardize service delivery.

CBO Reestimates

CBO has reestimated the President's budget request upward by a total of $16.4 billion for 1987-1991. Most of this increase results from the higher cost-of-living adjustments (COLA) in the CBO economic assumptions. The difference is particularly significant in 1991, the year for which CBO projects a 4.3 percent COLA and the Administration shows no COLA, because it projects prices to increase by less than 3.0 percent. (Under current law, Social Security COLAs are delayed if the year-to-year price increase--measured on a third-quarter basis--is less than 3 percent.)

FUNCTION 700: VETERANS' BENEFITS AND SERVICES

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 700: VETERANS' BENEFITS AND SERVICES
(By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	27.0	27.8	28.1	28.5	29.2	
Proposed Changes						
Medical Care						
Reduce number of patients	-0.3	-0.6	-0.9	-1.0	-1.0	-3.7
Require insurance reimbursement	-0.1	-0.1	-0.2	-0.2	-0.2	-0.7
Loan Guaranty	-0.1	-0.2	-0.2	-0.2	-0.2	-0.9
Job Training	a/	-0.1	-0.1	-0.1	-0.1	-0.3
New GI Bill	a/	a/	a/	-0.1	-0.1	-0.2
Compensation	a/	a/	-0.1	-0.2	-0.6	-0.8
Other	a/	a/	-0.1	-0.2	-0.2	-0.5
Total	-0.6	-0.9	-1.4	-1.8	-2.3	-7.0
President's 1987 Budget as Estimated by CBO	26.5	26.9	26.7	26.7	26.8	
President's 1987 Budget	26.4	26.9	26.9	27.2	27.1	
CBO Reestimates	a/	a/	-0.2	-0.5	-0.3	-0.9

a. Less than $50 million.

Proposed Policy Changes

The President's 1987 budget for veterans' benefits and services proposes sharp reductions in spending for veterans' medical care, as well as changes in veterans' education, housing, and burial benefits.

Medical Care. The largest reductions proposed by the President in function 700 are in spending for medical care services provided by the Veterans Administration (VA). The outlays projected by the President over the 1987-1991 period are $4.4 billion below the CBO baseline. These spending cuts are to be achieved primarily through a reduction in the number of patients treated in VA health care facilities. In connection with this reduction, the Administration is again proposing a means test to assist the VA in identifying those veterans with the least need for free VA care. However, the President's requested budget authority levels would necessitate a reduction in the number of patients even if the means test were not enacted. The Administration has estimated that by 1991, hospital discharges and outpatient visits would each be reduced by 15 percent in order to achieve the spending reductions.

A means test for VA health care was also proposed in the President's 1986 budget but was rejected by the Congress in favor of a provision to require copayments by veterans without service-connected disabilities who have incomes above a certain level. The requirement of copayments, however, would reduce medical care outlays by far less than the Administration's means test. The Congressional proposal was included in the conference version of H.R. 3128, the 1986 reconciliation bill.

The President is also repeating his proposal to require third-party health care insurers to reimburse the VA for care provided to insured veterans without service-connected disabilities. The CBO estimates that the receipts from this proposal would be less than 60 percent of the amounts estimated by the VA, however. A similar provision was included in the conference version of H.R. 3128.

Loan Guaranty Revolving Fund. The 1987 budget includes a proposal to increase the origination fee required of veterans and others obtaining VA guaranteed and direct loans. The fee would be raised from its current level of 1.0 percent of the mortgage principal to 2.0 percent in 1987, 2.5 percent in 1988, 3.0 percent in 1989, and 3.8 percent in 1990 and thereafter. In his 1986 budget request, the President proposed that the origination fee be increased to 5.0 percent.

The VA estimate of the savings from this proposal assumes that the only effect would be an increase in fee collections. The CBO estimate, on the other hand, assumes that the rising fees would reduce the demand for loans and increase default rates. This results in a lower CBO estimate of savings in the out-years than that reflected in the President's budget.

Job Training. The President has not requested any funding for veterans' job training. Since the CBO baseline assumes that the job training program will be extended at the current level, the Administration's proposal would result in outlay savings of between $49 million and $66 million a year.

New GI Bill. The President has proposed to repeal the All-Volunteer Force Educational Assistance program (New GI Bill) starting on October 1, 1986, and to reinstate the Post-Vietnam Era Veterans' Educational Assistance program (VEAP). Under current law, this change is not scheduled to occur until June 30, 1988. The savings from the President's proposal result from the fact that the increase in VEAP outlays would not be as large as the reduction in New GI Bill spending, especially in 1990 and 1991.

Compensation. Even though the compensation program is not indexed by law, its benefits historically have been increased for inflation each year through legislation. Both the CBO baseline and the President's budget request reflect these out-year inflation increases. The President's budget, however, assumes significantly lower cost-of-living adjustments (COLAs) than are reflected in the CBO baseline. Because the compensation COLAs are discretionary, CBO's estimate of the President's budget uses the budget's assumed COLA levels.

Other. In a variety of medical and other accounts, the President's requested budget authority does not accommodate the full effects of inflation, which are assumed in the CBO baseline.

CBO Reestimates

In addition to the CBO reestimates of the impact of the President's legislative proposals, there are a number of reestimates of current law spending. Lower outlay estimates in compensation and pensions, resulting from lower average benefit projections, and a slower spending estimate in the Construction and Major Projects appropriation account cause the CBO estimate to be more than $900 million below the President's over the five-year period.

Credit Programs

The President's proposed increase in the loan origination fee would affect guaranteed loan commitments, in addition to lowering program outlays. The CBO estimates that the demand for new loans would fall by approximately 15 percent by 1991, because some marginal borrowers would no longer be able to qualify for mortgages after the higher fee level is added to the mortgage principal. Other borrowers may find conventional financing to be more advantageous in light of the higher fees. The Administration has assumed that the fee increase would not affect the demand for loans. These proposals are summarized in the table on the following page.

MAJOR CREDIT PROGRAM CHANGES PROPOSED FOR BUDGET FUNCTION 700: VETERANS' BENEFITS AND SERVICES
(By fiscal year, in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
			Guaranteed Loan Commitments			
CBO Baseline	16.3	16.9	17.5	18.1	13.8	
Proposed Changes						
Loan Guaranty	-0.7	-1.1	-1.5	-2.1	-2.2	-7.0
President's 1987 Budget as Estimated by CBO	15.6	15.9	16.1	16.0	16.6	

FUNCTION 750: ADMINISTRATION OF JUSTICE

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 750: ADMINISTRATION OF JUSTICE
(By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	7.0	7.1	7.3	7.4	7.5	
Proposed Changes						
FBI and DEA	0.1	0.1	0.1	0.1	0.1	0.6
The Judiciary	0.1	0.2	0.2	0.2	0.2	0.8
Legal Services Corporation	-0.3	-0.3	-0.3	-0.4	-0.4	-1.7
Criminal Justice Assistance	-0.1	-0.2	-0.2	-0.2	-0.1	-0.9
Other Enforcement, Litigative, and Correctional Activities	0.2	0.3	0.3	0.2	0.2	1.2
Total	0.1	0.1	a/	0.1	0.1	0.1
President's 1987 Budget as Estimated by CBO	7.1	7.2	7.3	7.3	7.4	
President's 1987 Budget	6.9	7.0	7.1	7.1	7.2	
CBO Reestimates	0.1	0.2	0.2	0.2	0.2	1.0

a. Less than $50 million.

Proposed Policy Changes

Unlike most functions in the budget, the President is proposing to increase funding for the administration of justice in 1987 and to maintain spending at clsoe to the baseline level over the 1987-1991 period. Increased spending is being proposed for law enforcement, particularly drug enforcement, prison construction and maintenance, and federal litigative activities. These increases are partially offset by proposed reductions in legal services for the poor and justice assistance programs.

The Administration is requesting additional funding for the Federal Bureau of Investigation (FBI) and Drug Enforcement Administration (DEA) to increase personnel and acquire advanced technology. The requested 1987 budget authority for these agencies is $1.7 billion, compared with the CBO baseline of $1.6 billion. The planned increases are for additional FBI positions for foreign counterintelligence and support staffing, for additional DEA drug enforcement agents, and for the design and development of investigative computer capabilities. The Administration is requesting an additional $27 million in budget authority for implementation of a system to maintain privacy of investigative communications at these agencies. The budget includes spending for these agencies that is about $0.6 billion above the baseline for 1987-1991.

The President's budget includes additional spending for judicial activities, largely for supporting personnel, especially clerks for bankruptcy offices. Increases over the baseline are also requested for other Department of Justice activities, including litigation and operation of the federal prison system. Total outlays for the department's litigative and correctional activities would be about $1.1 billion above the baseline over the 1987-1991 period, and spending for other law enforcement agencies would be about $0.2 billion above the baseline for the five-year period.

The President is also proposing selected reductions in this function. As in previous years, this budget proposes to terminate the Legal Services Corporation in 1987, with savings of $300 million to $400 million annually relative to the CBO baseline. Unobligated funds for justice assistance would be rescinded in 1986 and programs reduced or eliminated in 1987. Grants for juvenile justice and delinquency programs, as well as state and local assistance, Mariel Cubans, and the regional information sharing system would be terminated. In addition, the Administration is proposing to limit obligations from the Crime Victims fund to $35 million in 1987 and later years. Spending reductions for justice assistance would total $0.9 billion from 1987 through 1991.

CBO Reestimates

Based on historical spending rates, CBO estimates slightly higher spending than the Administration for programs in this function.

FUNCTION 800: GENERAL GOVERNMENT

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 800: GENERAL GOVERNMENT (By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	5.7	5.9	5.9	6.2	6.3	
Proposed Changes						
Internal Revenue Service	0.5	0.8	1.0	1.1	1.1	4.5
Legislative Branch	0.2	0.2	0.1	0.1	0.1	0.7
Government-sponsored Enterprise Fees	a/	-0.2	-0.5	-0.7	-1.0	-2.4
Customs Fees	-0.5	-0.5	-0.5	-0.5	-0.5	-2.5
Federal Financing Bank	0.2	0.2	0.4	0.3	0.2	1.3
Other	0.1	---	---	-0.1	-0.1	-0.1
Total	0.5	0.5	0.5	0.2	-0.2	1.5
President's 1987 Budget as Estimated by CBO	6.2	6.4	6.4	6.4	6.0	
President's 1987 Budget	6.1	5.7	6.1	5.9	5.6	
CBO Reestimates	0.1	0.7	0.3	0.5	0.4	2.0

a. Less than $50 million.

Proposed Policy Changes

The President is proposing increased funding for general government activities that, when offset by proposed user fees, would result in outlays $1.5 billion above the baseline over the 1987-1991 period. The largest increase is for the Internal Revenue Service, to fund several initiatives aimed at increasing revenue collections, including the hiring of 7,500 new examiners beginning in 1987. Additional spending would be more than $1.0 billion a year by 1990, and would total $4.5 billion over the five-year period. Increases above the baseline are also requested for many legislative branch accounts.

The budget also assumes enactment of the conference provisions of H.R. 3128, the Consolidated Omnibus Budget Reconciliation Act of 1985, which authorize the Customs Service to collect user fees for the processing of passengers and commercial carriers entering the United States. The Administration intends to propose additional fees for the processing of merchandise, with total collections from customs fees estimated to be $0.5 billion annually.

The budget includes a proposal, similar to one in the 1986 budget, to levy an annual fee on debt and other securities issued by government-sponsored enterprises, beginning in 1987. The affected enterprises include the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), the Student Loan Marketing Association (Sallie Mae), the Farm Credit System, and the Federal Home Loan Bank System. The fees would vary among institutions according to the extent of government risk. Fees would begin at 0.1 percent for net new debt issued in 1987, except for the Farm Credit System, which would start at a fee of 0.01 percent. By 1991, fees on net new debt would rise to 0.5 percent for Fannie Mae and the Farm Credit Banks, and to 0.15 percent for the other affected enterprises. These fees would raise $2.4 billion over the 1987-1991 period, as larger amounts of debt become subject to the annually increasing fees. (These fees are discussed further in Appendix A.)

The budget also proposes to show the surplus income of the Federal Financing Bank in the net interest function of the budget rather than in the general government function, which would increase general government outlays by $1.3 billion over five years, but would have no net effect on the budget.

CBO Reestimates

The budget assumes that renewed efforts to identify and sell surplus federal property would raise about $1.5 billion over the 1987-1991 period. Because earlier attempts by the Administration to sell property fell substantially short of stated goals, CBO estimates that surplus property sales will result in receipts of only $0.3 billion over the next five years. For a number of other programs, CBO has estimated outlays greater than in the budget, based on historical patterns.

FUNCTION 850: GENERAL PURPOSE FISCAL ASSISTANCE

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 850: GENERAL PURPOSE FISCAL ASSISTANCE
(By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	6.2	6.6	6.7	6.8	6.9	
Proposed Changes						
Elimination of General Revenue Sharing	-4.2	-4.6	-4.6	-4.6	-4.6	-22.6
Payments to states, mineral and timber receipts cost sharing	-0.2	-0.2	-0.3	-0.3	-0.3	-1.3
Other	a/	a/	0.1	0.1	0.1	0.3
Total	-4.4	-4.8	-4.8	-4.8	-4.8	-23.6
President's 1987 Budget as Estimated by CBO	1.7	1.8	1.9	2.0	2.1	
President's 1987 Budget	1.7	1.8	1.9	2.0	2.0	
CBO Reestimates	a/	a/	a/	a/	0.1	0.1

a. Less than $50 million.

Proposed Policy Changes

The President's budget proposes a sharp reduction in general purpose fiscal assistance funds provided to state and local governments, largely by eliminating General Revenue Sharing (GRS). Total spending for the function would decline from $5.9 billion in 1986, to $1.7 billion in 1987, with slight increases thereafter.

Between 1981 and 1985, GRS provided $4.6 billion annually in unrestricted grants to approximately 39,000 local governments--counties, municipalities, townships, and Indian tribes. For 1986, the Congress reduced funding to $4.2 billion, before reductions required by the 1985 Balanced Budget and Emergency Deficit Control Act. Elimination of GRS, including a rescission of the fourth quarterly payment for 1986, would result in savings from the CBO baseline of approximately $4.2 billion in 1987 and $4.6 billion annually thereafter, for total savings over five years of $22.6 billion. The Administration argues that local governments have become less dependent on revenue sharing funds and that the federal government can no longer afford the program.

The President's budget would also reduce the amount of federal timber and mineral receipts shared with state and local governments by calculating their share after deducting collection costs. Currently the states' and counties' share of such receipts is calculated by the Forest Service and Bureau of Land Management as a percentage of gross, not net, receipts. CBO estimates that this proposal would result in savings of approximately $240 million in 1987, increasing to $270 million in 1991.

CBO Reestimates

CBO's outlay estimates do not differ significantly from the Administration's estimates for this function.

FUNCTION 900: NET INTEREST

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 900: NET INTEREST (By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	145.0	154.4	157.6	159.1	160.3	
Proposed Changes						
Public Debt	-1.2	-3.4	-6.5	-10.1	-13.9	-35.1
HUD Interest	1.4	1.5	1.6	1.7	1.8	8.0
Federal Financing Bank	0.1	0.3	0.5	0.7	1.1	2.7
SBA Interest	-0.4	0.1	0.2	0.3	0.3	0.5
Sale of Bonneville Power Administration	0.0	0.0	0.2	0.2	0.2	0.6
Other	-0.2	-0.2	-0.3	0.2	-0.1	-1.1
Total	-0.2	-1.7	-4.4	-7.4	-10.7	-24.4
President's 1987 Budget as Estimated by CBO	144.7	152.7	153.2	151.7	149.6	
President's 1987 Budget	148.0	145.1	136.0	125.6	115.9	
CBO Reestimates	-3.3	7.6	17.2	26.1	33.8	81.4

Proposed Policy Changes

The largest change in net interest spending in the budget occurs because the Administration's projected deficits are lower than those contained in the CBO baseline. The lower deficits are the consequence of the proposed spending cuts, which reduce the government's borrowing needs and its interest costs. These interest savings rise dramatically over time, from $1.2 billion in 1987 to $13.9 billion in 1991.

Several of the proposals would increase net interest outlays compared with the CBO baseline. The largest of these is the forgiveness of an interest payment owed by the Department of Housing and Urban Development (HUD) to the Treasury. Since passage of the Deficit Reduction Act of 1984 (Public Law 98-369), HUD has financed the low-rent public housing program by direct loans rather than by guaranteeing the tax-exempt market borrowing of local public housing authorities. In 1985, when approximately $14 billion in outstanding guaranteed loans reached maturity, HUD borrowed from the Treasury to redeem the loans. HUD now owes the Treasury this $14 billion, plus capitalized interest, plus additional debt service. The Administration proposes to forgive this obligation and any interest due the Treasury. This proposal reduces outlays in budget function 600 (Income Security) by $1.4 billion in 1987 and by $1.8 billion in 1991. Because interest receipts in the net interest function are reduced by an equal amount, the proposal has no net budgetary effect.

The President's budget proposes to curtail the Federal Financing Bank's (FFB) lending activity. By the end of 1991, total FFB loans outstanding are projected to be $153 billion, under the President's proposals, compared with $173 billion in the CBO baseline. As a result, interest receipts from the FFB are only slightly lower than the CBO baseline in 1987, but are lower by $1.1 billion in 1991. (Since FFB interest enters the budget as an offsetting receipt--a negative outlay--reductions in interest receipts are recorded with a positive sign.)

Two of the President's proposals that affect net interest involve the sale of assets. The sale of the loan portfolios of the Small Business Administration (SBA) would reduce interest receipts by $0.5 billion over the 1987-1991 period. The proposal to sell the Bonneville Power Administration (BPA) in 1988 results in a loss of interest receipts to the Treasury from BPA's borrowing. The loss is $0.2 billion in each year, from 1989 through 1991. The proceeds from the proposed sales are shown in budget functions 370 and 450 (for SBA) and 950 (for Bonneville).

Other proposals result in small changes in net interest. Among these are reclassifying the FFB surplus (interest receipts in excess of administrative costs) from general government (budget function 800) to net interest, increasing the FFB lending premium from one-eighth percentage point to one-half percentage point, and various changes that affect intragovernmental interest receipts.

CBO Reestimates

Of the $81.4 billion in reestimates made to the budget's net interest figures over the 1987-1991 period, over two-thirds--$57 billion--results from differences in interest rate assumptions. These reestimates range from

-$1.6 billion in 1987 (when CBO's interest rate assumptions are below the President's for most of the fiscal year) to $24.1 billion in 1991.

Another $26 billion in reestimates over the five-year period results from deficits that are higher than those contained in the President's budget. Because of reestimates revenues and outlays in other budget functions, CBO projects that federal borrowing needs would be higher than those forecast by the Administration. Additional interest costs from this borrowing grow from $0.8 billion in 1987 to $9.3 billion in 1991.

The rest of the CBO reestimates of net interest are of varying signs, and their effect over the 1987-1991 period totals -$1.6 billion. One of the largest among these reestimates is for interest receipts from Outer Continental Shelf escrow accounts, where CBO estimates differ in timing and amount from those of the Administration, as discussed in budget function 950. Additional reestimates result from different assumptions about patterns of lending through the FFB and other programs, different assumptions about the maturity mix of Treasury borrowing, and other factors. These reestimates are more fully discussed in Appendix C.

FUNCTION 920: ALLOWANCES

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 920: ALLOWANCES (By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	1.1	3.2	5.5	8.0	10.7	
Proposed Changes						
Civilian Agency Pay Raises	-0.7	-1.3	-2.5	-3.7	-5.2	-13.4
Increased Employer Share, Employee Retirement	0.3	0.5	0.4	0.4	0.4	2.0
Total	-0.4	-0.8	-2.0	-3.3	-4.8	-11.3
President's 1987 Budget as Estimated by CBO	0.7	2.3	3.5	4.7	5.9	
President's 1987 Budget	0.8	2.4	3.5	4.7	5.9	
CBO Reestimates	a/	a/	a/	a/	-0.1	-0.2

a. Less than $50 million.

Proposed Policy Changes

The allowances function contains two proposals affecting pay levels and retirement contributions for employees of civilian agencies. The Administration is proposing to limit pay rate increases to 3.0 percent each year for white- and blue-collar civilian employees, effective in January for white-collar employees and with a three-month delay for blue-collar employees. The Administration, however, requests only one-half of the amount necessary to fund the proposed increase in 1987. Thus, civilian agencies would be required to pay for 50 percent of the 1987 pay raise from other funds. On the other hand, the Administration requests funding of the total cost of the 1987 pay raise for Department of Defense civilians, shown in the national defense function. Uniformed employees of civilian agencies would receive the same increases as Department of Defense military employees.

The CBO baseline assumes pay rate increases equal to the annual rate of projected growth in private-sector pay: 3.3 percent in fiscal year 1987, 5.8 percent in 1988, 5.9 percent in 1989, 5.9 percent in 1990, and 6.1 percent in 1991, effective in October each year for white-collar employees. CBO estimates that the Administration's proposal will reduce outlays by $0.7 billion in 1987 and by a total of $13.4 billion through 1991, compared with the CBO baseline.

The Administration also proposes to increase the amount that all civilian workers and their employing agencies pay into the Civil Service Retirement trust fund from 7 percent to 9 percent of earnings, beginning in January 1987. The Administration includes an allowance in this function to cover the cost of the additional contributions by civilian agencies, excluding the U.S. Postal Service. An allowance for increased contributions by the Department of Defense for its civilian employees is included in the national defense function.

CBO estimates that this proposal would increase the contributions of employing agencies by $0.3 billion in 1987, and by a total of $2.0 billion through 1991. These increased agency contributions, however, are also reflected as offsetting receipts in budget function 950 and have no net budgetary effect. (The increased employee contributions to Civil Service Retirement are shown in the budget as higher revenues.)

CBO Reestimates

CBO's outlay estimates do not differ significantly from the Administration's estimate for this function.

FUNCTION 950: UNDISTRIBUTED OFFSETTING RECEIPTS

MAJOR SPENDING CHANGES PROPOSED FOR BUDGET FUNCTION 950: UNDISTRIBUTED OFFSETTING RECEIPTS
(By fiscal year, outlays in billions of dollars)

Item	1987	1988	1989	1990	1991	Cumulative Five-Year Changes
CBO Baseline	-35.9	-39.8	-41.1	-42.6	-45.4	
Proposed Changes						
Employer Share, Employee Retirement	-0.9	-1.3	-1.3	-1.1	-0.1	-4.7
Sale of Naval Petroleum Reserves a/	---	-2.4	---	---	---	-2.4
Sale of Power Marketing Administrations a/	---	-0.8	-8.5	-1.6	-1.4	-12.3
Total	-0.9	-4.5	-9.8	-2.7	-1.5	-19.4
President's 1987 Budget as Estimated by CBO	-36.8	-44.2	-50.9	-45.3	-46.8	
President's 1987 Budget	-38.1	-46.4	-43.8	-49.3	-50.2	
CBO Reestimates	1.3	2.2	-7.1	3.9	3.3	3.6

a. The receipts from the proposed sale of the Naval Petroleum Reserves and the power marketing administrations appear in function 950. Function 270 outlays would increase relative to the baseline after the sales occur, because these assets would no longer generate receipts for the government.

Proposed Policy Changes

The budget includes new measures for increasing undistributed offsetting receipts by about $19.4 billion over the 1987-1991 period. First, the President's budget proposes several changes that would increase offsetting receipts for the employer's share of employee retirement. The President requests lower military and civilian pay increases than assumed in the CBO baseline. The budget also assumes that the percentage of basic pay required for military retirement contributions is lower than that assumed by CBO. This results in offsetting receipts that are initially below those in the CBO baseline. Increases in receipts resulting from proposed legislation, however, more than offset these decreases. Proposed legislation includes an increase of 2 percent in federal employers' payments for the costs of Civil Service and Foreign Service Retirement. The U.S. Postal Service and the District of Columbia would be required to pay the full government share of the cost of their employees' retirement. The net effect of these proposals is to increase offsetting receipts by $0.9 billion in 1987, declining to $0.1 billion by 1991. These changes simply represent larger intragovernmental transfers.

The President also is proposing to sell the government's interests in the Naval Petroleum Reserves (NPRs) and the power marketing administrations (PMAs). If undertaken, these sales are likely to occur over the next several years, probably beginning no earlier than 1988. CBO estimates that receipts from these sales would total $14.8 billion over the 1988-1991 period. Spending in budget function 270 (Energy) would increase by about $3.6 billion in this period, however, because the government would not receive the net income that these assets would generate if not sold. Income would be lost in years after 1991 as well.

Naval Petroleum Reserves. The government owns approximately 78 percent of the Elk Hills oil field, known as NPR-1, and 100 percent of the Teapot Dome oil field, known as NPR-3. Selling these interests is estimated to increase federal receipts by $2.4 billion in 1988. The selling price is highly dependent on the timing of these sales and the private market's expectations of future oil prices. If the sale were to take place in 1987, the expected bids could be $3 billion or higher because of the greater income potential to the buyer by owning and operating the oil fields for another year. On the other hand, if oil prices are expected to remain below $20 per barrel, the total bids for the NPRs could be less than $2 billion in 1988. Lost receipts from oil sales would be about $0.8 billion in 1988 and $2.6 billion over the 1988-1991 period.

The budget includes receipts from the sale of the NPRs of $1.2 billion in 1987 and $2.4 billion in 1988, for a total of $3.6 billion. CBO estimates total receipts of $2.4 billion, all in 1988. The primary reason for the reestimate is that CBO expects that the sale of the NPRs would not be completed until 1988, while the Administration assumes that the sale would occur in 1987. CBO estimates a lower sale price, because it assumes lower oil prices and because the value of the reserves declines over time as more of the proved oil reserves are produced and sold. (On the other hand, later sale would also result in higher receipts from the sale of NPR oil in budget function 270.)

Power Marketing Administrations. The President recommends selling the five power marketing administrations (PMAs) in the Department of Energy: the Alaska PMA, the Bonneville Power Administration (BPA), the Southeastern PMA, the Southwestern PMA, and the Western PMA. These agencies sell and transmit the electricity produced at federal dams owned and operated by the Corps of Engineers and the Bureau of Reclamation. Together they market about 9 percent of the electricity sold in the United States, and have a book value of about $15.6 billion. The Administration believes that marketing electricity is no longer a federal responsibility, and that states, localities, and private management could be more responsive to customer needs. CBO estimates that the government could receive about $12.3 billion from such sales by 1991, which would be partially offset by lost income (in the energy function) of about $1 billion in 1990 and 1991 and additional amounts in subsequent years.

Potential receipts from selling the PMAs are very uncertain, because of the differing values of these assets to prospective buyers, and because of the uncertain impact of the sale on federal tax revenues. Although the President's estimate of $13.9 billion in sales receipts falls within a range of possible values, CBO estimates that the receipts are likely to be lower--about $12.3 billion by 1991. This estimate assumes that purchasers would be able to set electric rates to their customers at competitive levels, and that purchase prices will reflect this expectation. The reestimate also reflects CBO's assumption that all of the assets of the Bonneville Power Administration will be sold at the same time (in fiscal year 1989) and that the government will receive full payment in that year. The budget figures, on the other hand, arbitrarily spread the payments out over a number of years.

Conrail. The President's budget assumes that Conrail will be sold to the Norfolk Southern Corporation in fiscal year 1986. CBO estimates that the government would receive $1.25 billion at the time of such sale, but would lose, over the 1987-1991 period, approximately $1.0 billion in interest and dividend payments from Conrail and about $0.5 billion in tax revenues. (The dividend and interest losses would be reflected in budget function 400.)

CBO Reestimates

The President's budget projects receipts from the Outer Continental Shelf and the sale of the NPRs and PMAs that are $5 billion greater than those estimated by CBO over the 1987-1991 period. However, because the CBO estimate of receipts from retirement contributions is $1.4 billion greater than the Administration's, the net estimating difference in this function for the five-year period is $3.6 billion. The effect of the CBO reestimates is to increase budget outlays by $3.6 billion above the level estimated by the Administration for the 1987-1991 period.

APPENDIXES

APPENDIX A

THE ADMINISTRATION'S CREDIT INITIATIVES

The Balanced Budget and Emergency Deficit Control Act of 1985 fully integrates federal credit programs into the required, phased reduction of the budget deficit. The President's 1987 proposals contain a number of changes in federal credit assistance that would reduce the deficit. These proposals fall into three general categories: those that would reduce program activity; those that would change direct loan programs to loan guarantees; and structural changes, including loan asset sales and user fees for sponsored financial intermediaries. Although all these changes could contribute to short-term deficit reduction, they have somewhat different long-term budgetary effects and capital market implications. This appendix describes the President's credit budgetary reduction strategies by broad category and discusses their effects on the budget and credit markets.

The magnitude of the President's credit reduction proposals is summarized in Table A-1. New direct loans over the next five years would be reduced by $45 billion or 25 percent from CBO projected baseline levels. New loan guarantee commitments would be reduced by $98 billion or 21 percent.

PROGRAM REDUCTIONS

The President proposes to reduce the levels of credit activity by lowering both the supply and demand for federal credit assistance.

To reduce the supply of credit, the President proposes to terminate programs. Direct lending for rural housing by the Farmers Home Administration is to be terminated and replaced in part by Housing and Urban Development (HUD) housing vouchers. Water and waste disposal, community facilities, and industrial development loans now provided by the Farmers Home Administration are to be discontinued. The direct loan and loan guarantee programs of the Small Business Administration are to be halted. Ship construction loan guarantees will no longer be available from the Maritime Administration if the President's proposal is adopted. Agency for International Development housing loan guarantees and Department of Education subsidized college housing loans would also be ended.

The demand for federal credit assistance would be reduced by placing restricitons on the eligibility of beneficiaries and by lowering the amount of the subsidy conveyed in many assisted transactions. Mortgage loan guarantees from the Federal Housing Administration would be available in the future only to those with gross family incomes of $40,000 or less, thus reducing the potential number of eligible borrowers. The up-front insurance premium on FHA loans would be increased from 3.8 percent of principal to 5 percent, and these premiums and other closing costs could no longer be financed by adding them to the loan amount. The rate of interest on Rural Electrification Association direct loans would be raised from 5 percent to the Treasury's cost of money plus 1 1/8 percent. The interest rate on National direct Student Loans would rise from 5 percent to 3 percent above the 91-day Treasury bill rate. The origination fee charged by the Veterans Administration on mortgage loan guarantees would be raised in steps from 1 percent of principal to 3.8 percent by 1990.

TABLE A-1. PROPOSED CHANGES IN CREDIT PROGRAMS
(By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	Cumulative Five-Year Total
			Direct Loans			
CBO Baseline	37.5	36.1	35.2	34.2	33.9	176.9
Proposed Changes	-5.3	-7.2	-9.2	-11.1	-11.9	-44.7
President's 1987 Budget as Estimated by CBO	32.2	28.9	26.0	23.1	22.0	132.2
			Primary Guaranteed Loans			
CBO Baseline	88.1	91.6	94.7	97.9	101.3	473.6
Proposed Changes	-14.8	-16.9	-19.0	-21.5	-25.8	-98.0
President's 1987 Budget as Estimated by CBO	73.3	74.7	75.7	76.4	75.5	375.6

SOURCE: Congressional Budget Office.

Both of these approaches will reduce activity levels in federal credit programs. The supply side restrictions will do so directly; the demand side measures will do so by restricting eligibility and by increasing the attractiveness of alternatives to federal assistance. Reductions in new direct loan disbursements will have a direct and immediate effect on current budget outlays. Disbursements that otherwise would have occurred will be avoided. In future years, however, repayments of principal and interest that would have been received will not take place. Reduced levels of new loan guarantee commitments have a more distant effect on outlays because the costs of a guarantee is recognized in the budget only when a guaranteed borrower defaults and the government must honor its commitment. Thus, the budget saving from lower levels of guarantees will occur mostly in the budget out-years.

To the extent that activity levels decline because of the increase in guarantee fees and direct loan interest charges, current year collections from the higher charges will be offset by the reduced volume of loans. The size of the offset will depend on the sensitivity of demand to these higher fees.

The capital market effects of these proposed changes depend largely on how the potential beneficiaries of federal credit programs react. To be sure, as program levels decline, the federal government will have to borrow less to finance its direct loans and to honor its guarantee commitments. But to some extent, borrowers excluded from federally assisted credit, either by program cutbacks or higher fees, will borrow from other sources. Consequently, the total demand for credit will not be reduced by the amount of the federal reduction. At one extreme, if all federally-assisted borrowers excluded by these program cutbacks switched to private lenders instead, the total demand for credit would be unchanged. At the other extreme, if none of those squeezed out of the federal programs obtained credit elsewhere, total credit market demand would fall by the full amount of the proposed volume reductions. In fact, some but not all excluded federal borrowers will obtain credit elsewhere. The most deeply-subsidized borrowers in federal programs are most likely to be unwilling, and perhaps unable, to find credit elsewhere.

CHANGE DIRECT LOANS TO GUARANTEES

The President proposes to change several direct loan programs to loan guarantees. Important examples are the farm operating and farm ownership loans of the Agricultural Credit Insurance Fund (ACIF) administered by the Farmers Home Administration and the direct loan program of the Export-Import Bank of the United States (Eximbank).

Currently, ACIF provides direct loans to farmers at interest rates below 9 percent for up to seven years for operating loans and up to 40 years for ownership loans. The Office of Management and Budget (OMB) estimates that in 1985 these concessionary loan terms constituted a subsidy with a present value equal to 14 percent of direct loan obligation for operating loans and 28 percent of obligations for ownership loans. ACIF also guarantees loans extended by commercial lenders to qualified farmers. The ACIF guarantee permits the borrower to obtain funds on more favorable terms than would otherwise be available. OMB estimates that the subsidy value of guaranteed operating loans is 6 percent of principal, and that of guaranteed ownership loans is 15 percent of principal. Thus, to switch borrowers from more heavily subsidized direct loans to guarantees with only about half the subsidy would both reduce the demand for these loans and the government's cost per dollar of loans assisted.

The lower ACIF subsidy will diminish the demand for assisted lending, and the need for government funding of the loan will be reduced. As a consequence, short-term budget outlays will fall by the amount the cash disbursement and the interest rate subsidy are reduced. Direct demands by government on credit markets will be similarly reduced. Total credit demand will decline, however, only by the amount that former direct loan borrowers do not switch to guaranteed loans.

The Eximbank proposal is fundamentally different from the ACIF change. The Administration's proposes to restructure the subsidized loan program to finance the loans with agency guaranteed borrowing rather than by Treasury borrowing, without changing the nature or terms of the loans. Eximbank would continue to select the borrowers, provide an interest subsidy equal to the subsidy provided for a direct loan through the current program, and service the loan after arranging financing through a private lender. Lenders would be selected competitively, but would be guaranteed payment of interest and principal. Since borrowers would be subsidized as heavily as they are now, there would be no reduction in the cost to the government or in the federal intervention in the capital markets. The Eximbank guaranteed financing is equivalent to an agency debt transaction. The Congressional Budget Office (CBO) continues to record the subsidized loan transactions as direct loans, requiring budget authority and outlays by the agency. In contrast, the budget records them as guaranteed loans.

STRUCTURAL CHANGES

The President proposes that the government begin a pilot program of loan assets sales. The budget assumes that loans with a face value of $4.4 billion from 13 federal programs will be sold for revenues of $2.0 billion. The largest sales would be from the Small Business Administration disaster loan and business programs ($2.3 billion), Veteran's Administration vendee loans

($0.8 billion), college housing loans ($0.6 billion) and the Government National Mortgage Association tandem plan loans ($0.5 billion). The 1987 budget deficit would be reduced by $1.7 billion, but this decrease would be offset by future deficit increases as a result of reduced repayments received from the loans that have been sold.

The proposal to sell government loans is recommended not because of the deficit effect--which as noted above is temporary--but because of the potential for improving the management of federal credit programs. The price paid for the loans by the private investor provides an improved measure of the subsidy cost to the government of providing the loans. The investors will offer a price that will reflect the present value of the future stream of repayments expected for the loan. The face value of the loan will be discounted to reflect the difference between the rate for a comparable unassisted loan to the same borrower. The discount covers both the interest subsidy and the potential loss from default. The budget assumes that the discount will reduce the value of the loans from their face value of $4.4 billion to $2.0 billion. CBO has not reestimated the potential revenues from these sales. The sale of the loans is needed to provide better data on the appropriate discount rates. More informed decisions on the appropriate budget levels for credit programs should results from having better information on the cost of the subsidies conveyed by the federal loan.

The Administration's policy is to sell loans to the public without a government guarantee. This policy is important for two reasons. First, the sale of loan assets with a guarantee has the effect of exchanging one form of government paper (a government guaranteed security) for another (Treasury debt used to finance direct loans). No reduction in government intervention in the capital markets results from this exchange. Because of the relatively illiquid nature of the federal guaranteed security compared with Treasury debt, the guaranteed security will cost the government more than comparable Treasury securities. Second, the government guarantee obscures the value of the subsidy conveyed by the original federal loan. Not only does the guaranteed sale not have the intended economic effects, improvement in government credit management resulting from better cost information would be prevented.

The President has proposed user fees for government-sponsored enterprises, both to raise revenue and to improve credit management. Fees are to be levied on net new debt securities issuances by Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac), Federal Home Loan Banks, Farm Credit Banks, and Student Loan Marketing Association (Sallie Mae). In addition, a smaller fee is proposed for new mortgage backed securities issued by Fannie Mae and Freddie Mac. The fees would begin in 1987 and increase gradually through 1991. The fee schedule distinguishes the higher risk enterprises, Farm Credit and Fannie Mae, from other lower risk entities by a higher debt fee. The weakened, current financial condition of the Farm Credit System is recognized by the longer phase-in period.

TABLE A-2. MAJOR PROPOSED CREDIT PROGRAM CHANGES
(By fiscal year, in billions of years)

Major Program	1987	1988	1989	1990	1991	Cumulative Five-Year Totals
DIRECT LOANS						
CBO Baseline	37.5	36.1	35.2	34.2	33.9	176.9
President's Proposals						
Foreign Military Sales Credit	0.5	0.4	0.3	0.1	-0.1	1.2
Rural Electrification Direct Loans	-0.5	-0.6	-0.8	-1.0	-1.1	-4.0
Rural Electrification Guaranteed FFB	-0.7	-0.9	-1.0	-1.1	-1.1	-4.8
Export-Import Bank	0.7	0.6	0.6	0.6	0.5	3.0
Agricultural Credit Insurance Fund	-0.7	-0.1	-0.7	-1.2	-1.3	-4.1
Commodity Credit Corporation	a/	-0.2	-0.3	-0.4	-0.4	-1.3
Rural Housing Insurance Fund	-2.1	-2.2	-2.3	-2.4	-2.5	-11.5
FHA Guarantee Claims	0.0	0.1	0.2	0.3	0.5	1.1
Housing for the Elderly and Handicapped	-0.6	-0.6	-0.7	-0.7	-0.8	-3.4
Small Business Administration	-0.5	-0.9	-1.1	-1.1	-1.2	-4.8
Rural Development Insurance Fund	-0.4	-0.5	-0.5	-0.5	-0.5	-2.5
Rural Telephone Bank	a/	-0.1	-0.2	-0.2	-0.2	-0.7
SBA Disaster Loans	-0.7	-1.2	-1.2	-1.3	-1.3	-5.6
Low-Rent Public Housing	-0.1	-0.8	-1.0	-1.2	-1.3	-4.3
Other	-0.3	-0.2	-0.5	-0.8	-1.1	-2.9
Total, Direct Loans	-5.3	-7.2	-9.2	-11.0	-11.9	-44.6
President's Request	32.2	28.9	26.0	23.1	22.0	132.3
GUARANTEED LOANS						
CBO Baseline	88.1	91.6	94.7	97.9	101.3	473.8
President's Proposals						
Overseas Private Investment Corporation	0.0	0.0	-0.2	-0.2	-0.2	-0.5
AID Housing Guarantees	-0.2	-0.2	-0.2	-0.2	-0.2	-0.8
Export-Import Bank	-1.8	-2.2	-2.8	-3.3	-3.8	-13.9
Agricultural Credit Insurance Fund	0.0	0.0	0.4	0.7	0.6	1.7
Commodity Credit Corporation	-2.5	-2.5	-2.5	-2.5	-2.5	-12.5
Federal Housing Administration	-5.4	-6.9	-8.5	-10.2	-11.9	-42.9
Small Business Administation	-3.0	-3.1	-3.3	-3.4	-3.5	-16.4
Health Professions Guaranteed Student	-0.2	-0.2	-0.2	-0.2	-0.2	-1.1
VA Loan Guaranty Revolving Fund	-0.7	-1.0	-1.4	-2.1	-1.7	-6.9
Other	-1.1	-0.8	-0.3	-0.2	-2.4	-4.8
Total, Guaranteed Loans	-14.8	-16.9	-18.8	-21.4	-25.7	-97.6
President's Request	73.3	73.7	75.7	76.4	75.5	375.7

SOURCE: Congressional Budget Office.
a. Less than $50 million.

Over the next five years, these fees would raise approximately $2.4 billion. The fees should not significantly effect the extent of government capital market intervention, but would recognize, at least in part, the subsidies conveyed to these enterprises by their relationship to the government. The government-sponsored enterprises currently borrow at rates only slightly higher than Treasury securities as a result of their "agency" status. This competitive advantage would be recognized and partially offset by the fee that would raise the cost of their financing.

Table A-2 summarizes the major credit program changes proposed in the President's 1987 budget. The changes are shown relative to CBO's baseline projections and incorporate CBO reestimates of the budgetary effect of the Administration's proposals.

APPENDIX B

CBO REVENUE REESTIMATES

This appendix explains how CBO reestimated the Administration's budget revenues as published in the Budget of the U.S. Government for Fiscal Year 1987. It is a companion to Appendix C, which discusses CBO's reestimates of the Administration's expenditures. Although the two estimates of total revenues for 1987 are almost the same, CBO's estimates are above those of the Administration in four of six years by amounts that grow from $1.6 billion in 1986 to $3.8 billion in 1989 and to $26.1 billion in 1991. The CBO revenue reestimates produce a net increase of $42.6 billion above the Administration's projected revenues over the 1986-1991 period. Virtually all of this net increase is estimated to occur in 1990 and 1991 (see Table B-1).

Most of these upward reestimates result from differences between CBO's and the Administration's economic assumptions and arise as differences between CBO's baseline revenues and the Administration's current services revenues. Technical reestimates, about half of which derive from differences in estimates of proposed legislation and administrative actions, are small and, for the most part, offsetting.

REVENUE REESTIMATES REFLECTING DIFFERENT ECONOMIC ASSUMPTIONS

Since taxes are generally paid on the nominal values of the various tax bases and market transactions--personal and corporate incomes, imports, goods and services subject to excise taxes--different assumptions about the future values of these measures greatly affect the level of projected revenues. CBO's economic forecast supports higher levels of revenues than does the Administration's in 1986 and in each year after 1988. Economic reestimates appear by major tax source in Table B-2.

Personal and corporate income taxes and social insurance contributions account for most of CBO's economic reestimates. Differences in assumptions about the tax bases of these three major tax sources are shown in Table B-3.

CBO projects lower levels of taxable personal income through 1988, but significantly higher levels in the last three years of the projection period. This is directly responsible for somewhat lower individual income taxes early in the period and higher income taxes by growing amounts in 1989 and thereafter. The pattern of wage and salary assumptions roughly parallels that of the more aggregrate personal income assumptions. CBO's lower projections from 1987 through 1989 yield less revenue in payroll taxes, but the reverse is true in 1990 and 1991.

TABLE B-1. CBO'S REESTIMATES OF ADMINISTRATION'S BUDGET REVENUES (By fiscal year, in billions of dollars)

	1986	1987	1988	1989	1990	1991
Revenues as Estimated by Administration a/	777.1	850.4	933.2	996.1	1,058.1	1,124.0
CBO Reestimates by Type						
Different economic assumptions	2.2	-1.7	-4.2	1.2	11.1	21.9
Different technical assumptions						
Baseline	-0.8	1.9	-1.7	1.4	3.7	1.9
Proposals	0.1	-0.7	0.8	1.3	1.8	2.3
Subtotal	1.6	-0.4	-5.1	3.8	16.7	26.1
Revenues as Reestimated by CBO a/	778.7	849.9	928.1	999.9	1,074.8	1,150.2

SOURCES: Budget of the United States Government for Fiscal Year 1987 and Congressional Budget Office.

a. Aggregate revenues include payroll tax receipts of the Federal Old-Age and Survivors Insurance Trust Fund and Federal Disability Insurance Trust Fund (OASDI), which are off-budget.

TABLE B-2. CBO'S REVENUE REESTIMATES REFLECTING DIFFERENT ECONOMIC ASSUMPTIONS (By fiscal year, in billions of dollars)

Tax Source	1986	1987	1988	1989	1990	1991
Individual Income Taxes	-0.3	-2.8	-1.4	4.7	16.1	25.1
Corporate Income Taxes	1.7	2.6	-0.2	-2.0	-5.7	-9.9
Social Insurance Taxes	0.6	-0.8	-2.5	-2.2	0.7	7.5
Customs Duties	0.2	0.4	0.5	0.6	0.7	0.7
Other a/	0.1	-1.1	-0.6	0.1	-0.5	-1.5
Total Reestimates	2.2	-1.7	-4.2	1.2	11.1	21.9

SOURCE: Congressional Budget Office.
a. Estate and gift taxes, excise taxes, and miscellaneous receipts.

TABLE B-3. DIFFERENCES BETWEEN CBO AND ADMINISTRATION ECONOMIC ASSUMPTIONS ABOUT TAX BASES (By calendar year, in billions of dollars)

Tax Base	1986	1987	1988	1989	1990	1991
Taxable Personal Income	-3	-18	-6	34	91	173
Wage and Salary Disbursements	4	-11	-18	-8	33	85
Corporate Book Profits	11	a/	-8	-14	-32	-35

SOURCE: Congressional Budget Office.
a. Less than $500 million.

CBO's forecast of economic profits is below the Administration's in 1986 and 1987, but projected book profits (a closer measure to taxable profits) are higher--by $11 billion in 1986 and less than one-half billion dollars in 1987. This is because CBO's valuation of inventory profits is larger and its depreciation deductions for new investment are smaller than those of the Administration. CBO's lower investment assumptions lead to smaller estimates of tax credits taken on new investment. Together, these factors generate higher corporate income taxes in 1986, and in 1987 as well because of lags between corporations' receipt of income and their payment of the associated income tax. From 1988 through 1991, CBO's assumptions about both economic and book profits are below the Administration's by significant amounts. This results in negative reestimates of corporate income taxes by amounts that grow to $10 billion by 1991.

Economic assumptions about international trade have become increasingly important in estimating revenues because of the dramatic growth in the last two years in imports and, therefore, customs duties. CBO's higher projection of imports generates almost $1 billion more in duties each year after 1987 than the Administration projects.

REVENUE REESTIMATES REFLECTING DIFFERENT TECHNICAL ASSUMPTIONS

Technical reestimates are small, about $1 billion or less from 1986 through 1988 and between $3 billion and $6 billion in each of the last three years of the projection period. On balance, these raise estimated budget revenues by $12 billion over the six-year period (see Table B-4). They arise in estimates of both baseline revenues and the effects of proposed legislative and administrative changes.

CBO's estimates of baseline levels of unemployment insurance (UI) taxes are higher than the Administration's each year after 1986 because CBO assumes that, as estimated balances in trust funds grow, states will lower their UI tax rates more slowly than the Administration assumes. CBO's incorporation of recent data on the proportion of merchandise trade subject to duty and the effects of the changing composition of imports on the effective tariff rate results in higher customs duties projections than those of the Administration.

Reestimates of two proposals, taken together, account for $5.9 billion or about half of all technical reestimates. First, CBO has discounted the Administration's claim to $1.0 billion in petroleum overcharge restitution fees because it appears unlikely that legislation necessary to allocate the fees to the federal government can be introduced and passed before the early March deadline for disposition of these funds. Second, CBO estimates that the revenue effects of the proposed limitation on pay increases for federal civilian employees will have no net effect on revenues. The Administration's $6.9 billion revenue loss attributed to this administrative change requires the assumption that total wages in the economy will fall by the full amount of the pay reduction. CBO does not assume this to be a necessary outcome of such a policy change, thus raising projected budget revenues relative to Administration estimates by $6.9 billion over six years. These and all other proposals with revenue effects are discussed in Chapter II.

TABLE B-4. CBO'S REVENUE REESTIMATES REFLECTING DIFFERENT TECHNICAL ASSUMPTIONS
(By fiscal year, in billions of dollars)

	1986	1987	1988	1989	1990	1991
Individual Income Taxes	0.7	1.7	-2.6	0.5	2.2	1.2
Corporate Income Taxes	-0.4	0.1	0.2	-0.1	a/	0.2
Social Insurance Taxes	-0.2	0.3	1.1	1.8	2.1	0.7
Customs Duties	-0.3	0.3	0.8	1.2	1.6	2.0
Other b/	-0.4	-1.2	-0.4	-0.7	-0.3	a/
Total Reestimates	-0.6	1.2	-0.9	2.7	5.5	4.2

SOURCE: Congressional Budget Office.

a. Less than $50 million.
b. Estate and gift taxes, excise taxes, and miscellaneous receipts.

APPENDIX C

CBO OUTLAY REESTIMATES

As part of its analysis of the President's budget proposals, CBO has reestimated the Administration's outlay estimates using its own economic assumptions and technical estimating methods. By putting the two sets of estimates--the current policy baseline and the President's proposals--on a comparable footing, CBO provides its independent estimate of the budget impact of the policy changes that are proposed by the Administration.

Outlay reestimates stem from two sources: different economic assumptions and different technical estimating methods. Economic reestimates result from the use of different assumptions about unemployment, inflation, and interest rates. While the CBO and Administration forecasts are similar for 1986 and 1987, in later years the Administration assumes higher real economic growth, lower inflation, and lower interest rates than CBO (as discussed in Chapter I). Different economic assumptions primarily affect the spending projections for benefit programs such as Social Security and unemployment insurance, as well as the federal government's net interest costs.

Technical differences comprise estimating differences not directly attributable to economic assumptions. Assumptions about spendout rates--the speed at which budget authority in discretionary programs is translated into actual outlays--are one of the most important sources of technical reestimates. Other technical differences result from the use of more recent program data (such as crop projections), different evaluations of the proceeds and timing of asset sales, different assumptions about Treasury financing mix, and so forth.

CBO economic and technical reestimates combined add $16 billion to the Administration's outlay estimates for 1987, and $68 billion in 1991. These reestimates are discussed in more detail in the remainder of this appendix.

DIFFERENCES IN ECONOMIC ASSUMPTIONS

Different economic assumptions have little effect on the outlay estimates in 1986 and 1987 but account for large reestimates thereafter. By 1991, economic reestimates total $46 billion--over half of which is attributable to higher interest costs. CBO's economic reestimates of the President's projected outlays are shown in Table C-1.

Most of the large retirement and disability programs--Social Security, veterans' compensation and pensions, federal civilian and military retirement, and others--are allowed cost-of-living adjustments (COLAs) in January of each year. The increase is based on the year-over-year increase

TABLE C-1. CBO OUTLAY REESTIMATES RESULTING FROM DIFFERENT ECONOMIC ASSUMPTIONS (By fiscal year, in billions of dollars)

Program Type	1986	1987	1988	1989	1990	1991
Social Security and Other Indexed Programs	a/	-0.5	a/	2.0	5.2	15.8
Unemployment Compensation, Food Stamps, and AFDC	a/	0.2	0.2	0.6	1.0	1.5
Medicare and Medicaid	a/	0.1	-0.2	-0.2	0.3	1.4
Net Interest and Other Interest-Sensitive Spending						
Due to different rates	-1.2	-1.7	3.8	11.4	20.3	24.4
Due to different deficits	-0.1	-0.3	a/	0.8	1.9	3.1
Subtotal	-1.3	-2.0	3.8	12.2	22.2	27.5
Total	-1.3	-2.3	3.8	14.5	28.6	46.3

SOURCE: Congressional Budget Office.

a. Less than $50 million.

in the Consumer Price Index (CPI) in the third quarter of the previous year. CBO projects slightly lower inflation during the remainder of 1986 than does the Administration, leading to a slightly lower January 1987 COLA. In later years, CBO assumes modest annual declines in COLAs in contrast to the sharp declines used in the Administration's projections (Table C-2). The Administration's assumptions, in fact, imply no cost-of-living adjustment in January 1991 for Social Security and veterans' programs, because the year-over-year CPI increase falls below the 3 percent threshold specified in law.

The Administration assumes slightly lower unemployment rates during most of the 1987-1991 period than does CBO. As a result, CBO's estimates of outlays for unemployment compensation and other unemployment-sensitive programs are slightly higher than the Administration's, as shown in Table C-1.

The Medicare and Medicaid programs are sensitive to the rate of inflation in the health care sector, and the Medicaid program is sensitive to the unemployment rate. The Administration's budget includes a proposal to cap Medicaid growth after 1987 by the rate of medical care inflation. Because CBO assumes higher medical inflation, it reestimates the Administration's

TABLE C-2. COST-OF-LIVING ADJUSTMENTS ASSUMED BY ADMINISTRATION AND CBO (In percents)

Program	1987	1988	1989	1990	1991
Social Security and Veterans (January)					
Administration	3.7	4.3	3.6	3.3	a/
CBO	3.4	4.6	4.4	4.4	4.3
Military and Civil Service Retirement (January)					
Administration	3.7	4.3	3.6	3.3	2.7
CBO	3.4	4.6	4.4	4.4	4.3

SOURCES: Office of Management and Budget, Congressional Budget Office.

a. No cost-of-living adjustment.

outlays upward. Economic reestimates to Medicare and Medicaid total $0.1 billion in 1987 and $1.3 billion in 1987 through 1991.

By far the largest economic reestimate of outlays over the five-year period occurs in net interest and other interest-sensitive spending. As discussed in Chapter I, one of the sharpest differences between the Administration's and CBO's medium-term outlook lies in the interest rate assumptions. Both the Administration and CBO assume a decline in nominal interest rates over the five-year period, because of the federal government's commitment under the Balanced Budget Act to reduce deficits dramatically from current levels; and the Administration also assumes declining inflation. By 1991, both the Administration and the CBO assume a government bond rate about two and a half percentage points above the inflation rate and a short-term Treasury bill rate one to two percentage points above inflation--about equal to the average over the past 30 years. The CBO assumptions envision interest rates (adjusted for inflation) declining gradually during the intervening period as they approach these historical averages. The Administration, in contrast, assumes that inflation-adjusted rates return much sooner to their historical averages, as shown in Table C-3.

Projections of budget outlays depend on nominal interest rate assumptions. Because CBO's short-term interest rate assumptions are lower than the Administration's in 1986 (while the long-term rates are roughly the same), CBO estimates lower interest outlays for 1986 than does the Administration, as shown in Table C-1. Most of the reestimates occur in the net interest function--reflecting the government's interest costs on its borrowing and, as offsets, interest receipts on loans and on cash balances. (Other interest-sensitive outlays include guaranteed student loans, the Exchange Stabilization Fund, and Export-Import Bank programs.) While CBO's interest rate assumptions are slightly higher than the Administration's in calendar 1987, for most of the fiscal year short-term rates remain lower in the CBO forecast; as a result, CBO continues to project lower interest outlays in 1987. After 1987, however, CBO's economic reestimates due to interest rate assumptions are large and growing. In 1991, reestimates attributable to this source amount to $24.4 billion.

CBO's net interest projections also reflect the additional borrowing necessitated by other economic reestimates of outlays and revenues. As shown in Table C-1, the added debt service costs resulting from CBO's economic reestimates of the President's budget range from $-0.3 billion in 1987 to $3.1 billion in 1991.

Table C-1, along with the discussion in the previous appendix of CBO's revenue projections, make clear the critical importance of economic assumptions in federal budget estimates. Nevertheless, all economic assumptions are uncertain, especially those extending more than a few quarters into the future. Relatively small errors in the economic forecast can have large budget effects. A one-percentage-point change in the interest rate assumptions, for example, would add to CBO's estimate of the President's proposed outlays $10 billion in 1987 and $24 billion in 1991.

TECHNICAL ESTIMATING DIFFERENCES

CBO's technical reestimates add $18 billion to the President's outlay estimates in 1987 and $101 billion over the entire period from 1987 through

TABLE C-3. NOMINAL AND INFLATION-ADJUSTED INTEREST RATES ASSUMED BY ADMINISTRATION AND CBO
(By calendar year, in percents)

Rate	1986	1987	1988	1989	1990	1991
Nominal Interest Rates						
3-month Treasury bills						
Administration	7.3	6.5	5.6	4.8	4.3	4.0
CBO	6.8	6.7	6.4	6.1	5.8	5.4
20-year Treasury bonds						
Administration	8.9	8.5	7.3	5.5	4.8	4.5
CBO	9.3	9.1	8.4	7.7	7.0	6.4
Inflation-Adjusted Interest Rates						
3-month Treasury bills						
Administration	4.0	2.3	1.9	1.5	1.5	1.9
CBO	3.2	2.6	2.3	2.0	1.7	1.3
20-year Treasury bonds						
Administration	5.6	4.3	3.6	2.2	2.0	2.4
CBO	5.7	5.0	4.3	3.6	2.9	2.3
Memorandum: Gross National Product Deflator						
Administration	3.3	4.2	3.7	3.3	2.8	2.1
CBO	3.6	4.1	4.1	4.1	4.1	4.1

SOURCES: Office of Management and Budget, Congressional Budget Office.

1991. As shown in Table C-4, these technical reestimates are primarily in six areas: defense, agriculture, net interest, receipts from the Outer Continental Shelf, and sales of the government's Naval Petroleum Reserve and Power Marketing Administrations.

Defense (Function 050)

CBO reestimates add $14.5 billion to estimated defense outlays in 1987 and $17.5 billion in 1988, gradually declining to $10.6 billion in 1991. Over the entire five-year period, defense reestimates total $68 billion. The reestimates occur primarily in three areas: operation and maintenance (O&M); procurement; and research, development, test, and evaluation (RDT&E). O&M contributes relatively little to the total reestimate in 1987, and RDT&E contributes little after 1989 (see Table III-2 in Chapter III).

TABLE C-4. CBO OUTLAY REESTIMATES RESULTING FROM DIFFERENT TECHNICAL ASSUMPTIONS
(By fiscal year, in billions of dollars)

Program Area	1986	1987	1988	1989	1990	1991
Defense	3.7	14.5	17.5	13.8	11.7	10.6
Agriculture	4.5	2.3	3.8	0.1	-2.4	-1.5
Net Interest						
Due to different deficits	0.2	1.2	3.1	4.7	5.4	6.2
Other	-2.0	-2.5	1.0	0.7	-1.2	0.3
OCS Receipts	0.3	0.1	1.5	0.3	0.2	0.1
Naval Petroleum Reserves and Power Marketing Administrations	a/	1.2	1.0	-7.0	4.1	3.4
All Other	-1.9	1.1	1.8	0.7	1.0	2.0
Total	4.8	17.9	29.8	13.3	18.9	21.2

SOURCE: Congressional Budget Office.

1987 Reestimates. In fiscal year 1987, CBO estimates higher outlays both from budget authority requested for 1987 and from budget authority provided in earlier years. Specifically, CBO projects spending from new budget authority to be $5.6 billion higher than the Administration. Spending from prior years' budget authority is projected by CBO to be $8.9 billion higher. Table C-5 shows how these differences arise in the major accounts.

Because many defense activities require long-range planning and execution, defense budget authority is never spent entirely in the year it is made available. Outlay (or spendout) rates are the percentages of budget authority that are spent in the year of appropriation and following years. As such, they sum to 100 percent unless some amount of budget authority will lapse or never be spent. Estimating differences due to different outlay rates should tend to offset each other over time (as evidenced by the largely offsetting differences in O&M outlays for 1987 from new and prior years' appropriations).

The estimating difference for 1987 O&M accounts is relatively small given the $86 billion level of budget authority. The Administration has lowered its first-year O&M spendout rate from a year ago, to reflect an assumed slower spending program and other considerations. A difference of $3.9 billion reflects a four-percentage-point difference in the CBO and Administration first-year outlay rates. This difference is offset for the most part in assumed second- and third-year rates, as reflected by CBO's lower estimate ($3.2 billion) of outlays from prior years' budget authority. Thus

TABLE C-5. CBO AND ADMINISTRATION DEFENSE OUTLAY ESTIMATING DIFFERENCES BY BUDGET TITLE FOR 1987 (In billions of dollars)

Budget Title	Outlays From 1987 BA	Outlays From Prior Year BA	Total Outlays
Operation & Maintenance	3.9	-3.2	0.7
Procurement	-0.1	9.7	9.6
RDT&E	1.8	2.2	4.1
All Other, Net	-0.1	0.2	0.2
Total	5.6	8.9	14.5

SOURCE: Congressional Budget Office.

the net difference in CBO and Administration estimates of O&M spending in 1987 is relatively small--only $0.7 billion.

The net difference in procurement, $9.6 billion, is much more significant both in absolute terms and as a percent of program (about $90 billion per year since 1982). CBO's reestimate is almost entirely in outlays from prior-year authority. Procurement first-year spendout rates are very low, and so afford little room for disagreement. The spendout period for procurement is typically seven years or more. CBO estimates much higher outlays in 1987 from budget authority made available during the defense buildup begun by the previous Administration and accelerated during the current Administration.

Like procurement, the 1987 estimating difference in RDT&E is large in absolute and relative terms (about 10 percent of the 1987 request). Unlike procurement and O&M, the difference is split about evenly between outlays from new and prior-year budget authority. The first-year spendout rate for RDT&E is typically about 50 percent, but the remaining spending occurs over four or five years; in other words, the first-year rate is somewhat high (like O&M) and the spendout period is long (like procurement). As a result, there can be relatively large differences in first-year outlays without offsetting differences in outlays from prior-year authority.

1988-1991 Reestimates and the Relevance of Historical Spendout Rates. CBO's technical reestimates for 1988-1991 stem primarily from its application of historical spendout rates. The Administration, in contrast, implicitly uses spendout rates that are considerably lower than historical averages, citing management initiatives and other factors that it believes will lower these rates. For reasons that are discussed in Chapter III, CBO's view is that these management initiatives and other factors will not materially affect future spendout rates.

How well do historical spendout rates predict defense outlays? The spendout rates published by the Defense Department in its Financial Summary Tables published in conjunction with the 1987 budget are similar to CBO's assumptions and to historical experience. As discussed in Chapter III, CBO applied its own and the Department's spending rates to budget authority provided in previous years for the O&M, procurement, and RDT&E accounts to test their accuracy. Both sets of spendout rates produce similar results for the 1980-1985 period, as shown in Table C-6. For 1980 through 1983, current CBO and Defense Department spendout rates would both have underestimated actual outlays by $3 to $4 billion in each year, or by 2 to 4 percent. For 1984 and 1985, the current CBO and Defense Department spendout rates would have overestimated actual outlays by $3 to $6 billion, again by 2 to 4 percent. Over the entire six-year period, the average absolute percentage difference between these retrospective outlay estimates estimates and actual outlays is about 3 percent, with the CBO rates slightly closer than the Administration's.

Applying the Defense Department's spending rates to its budget authority proposals for 1987-1991 produces outlays that are very close to CBO's estimates, as discussed in Chapter III. These projections are well above the Administration's outlay estimates. CBO concludes that the factors cited by the Administration that would lower spendout rates are likely to have little effect, and that as a result defense outlays are substantially underestimated in the President's budget.

Agriculture (Function 350)

CBO reestimates for agricultural outlays are dominated by those of the Commodity Credit Corporation (CCC). CCC outlays in 1986 are likely to be about $4.3 billion above the levels projected by the Administration. CCC reestimates total $1.9 billion in 1987 and $2.6 billion over the 1987-1991 period. Generally, the reestimates are caused by differing assumptions concerning the supply and use of supported commodities and the Secretary of Agriculture's use of discretion in implementing provisions of the Food

TABLE C-6. DIFFERENCES BETWEEN OUTLAY ESTIMATES AND ACTUAL OUTLAYS FOR O&M, PROCUREMENT, AND RDT&E ACCOUNTS, 1980-1985 (By fiscal year)

Estimate Source	1980	1981	1982	1983	1984	1985
			Billions of Dollars			
Administration Rates	-3.3	-4.0	-4.2	-3.4	3.1	6.4
CBO Rates	-2.9	-3.3	-3.5	-3.1	3.3	6.4
			Percent			
Administration Rates	-3.8	-3.9	-3.5	-2.3	2.0	3.8
CBO Rates	-3.3	-3.2	-2.9	-2.2	2.1	3.8

NOTE: Negative values indicate that actual outlays exceeded the estimate.

SOURCE: Congressional Budget Office, based on data supplied by the Department of Defense.

Security Act of 1985. The 1986 reestimate is caused primarily by CBO's assuming lower levels of repayments of commodity loans on 1985 crops and slower implementation of the dairy termination program, in which producers will bid to remove their dairy herds from production in return for a government payment. CBO's estimate exceeds the Administration's in 1987 because CBO assumes that advance deficiency payments will be made on the 1987 and later crops, while the Administration assumes no such advance payments will occur.

The remaining reestimates are primarily attributable to the Agricultural Credit Insurance Fund (ACIF). The CBO estimates exceed the Administration's over the 1986-1989 period because CBO assumes lower repayments from the ACIF's existing loan portfolio.

Net Interest (Function 900)

Most of the technical reestimates of net interest result from the additional borrowing necessitated by other technical reestimates of revenues and outlays. These additional debt service costs add $20.5 billion over the 1987-1991 period.

Other technical reestimates of net interest include several components. Net interest on the public debt is reestimated downward in 1986 and 1987, by $1.6 billion and $0.9 billion respectively, but upward in later years. Total reestimates are $3.5 billion over 1987-1991. These reestimates result because CBO assumes lower interest payments on federal debt held by certain revolving trust funds and other funds in all years, based on the approximately two-percentage-point spread between the interest rates on this debt versus those on the debt held by non-revolving trust funds. The Administration assumes a much smaller spread. These downward reestimates are outweighed over time by additional outlays largely attributable to CBO's different financing mix assumptions. CBO assumes that only about one-fifth of new borrowing each year is accomplished through short-term Treasury bills, which carry lower interest rates than medium- and long-term securities. The Administration assumes one-half of new financing is in bills, although this would imply rapid escalation in weekly auction sizes and is at variance with recent Treasury practices.

CBO assumes about $1 billion larger intragovernmental interest receipts in 1987, and smaller reestimates in other years, mainly as a result of larger receipts from the Commodity Credit Corporation and the Agricultural Credit Insurance Fund. These reestimates--which reduce net interest outlays--are offset by upward reestimates in those programs that borrow through the Treasury.

Net interest includes interest disbursements from escrow accounts containing Outer Continental Shelf receipts that are currently the subject of dispute between the federal government and the states. The Administration assumes that the bulk of the funds will be disbursed in 1988 and 1989, on terms favorable to the federal government. CBO assumes different timing and amounts of escrow releases, as discussed further below. These differing assumptions cause CBO's estimate of net interest to be slightly lower in 1987 but $1.4 billion higher over 1987-1989, when all funds are assumed to be disbursed.

Other technical reestimates to net interest include CBO's estimate of higher interest receipts from loans based on different lending and repayment assumptions, smaller interest receipts from the foreign military sales program due to slower loan disbursements, and higher interest receipts from Treasury's cash balances in tax and loan accounts at commercial banks.

Outer Continental Shelf (Subfunction 953)

Differences between the President's budget and CBO's reestimate of Outer Continental Shelf (OCS) receipts are attributable primarily to different assumptions about escrow releases.

The disputes between the federal government and a handful of coastal states over the allocation of OCS receipts are in various stages of litigation or negotiation. These disputes arise because bonuses, rents, and royalties have been received for tracts that are adjacent to the boundary between federal and state jurisdictions. No agreement has been reached on the fair and equitable allocation of these receipts. CBO assumes that the Supreme Court will rule in 1987 on the boundary dispute with Alaska, and that other cases will be resolved in 1988 and 1989. CBO's estimates assign the federal government about 50 percent of the funds in dispute in most cases. CBO's 50 percent assumption is not a prediction of the legal outcome. Rather, the 50 percent figure reflects the midpoint of the two possible outcomes and is designed to make the budget projections less sensitive to errors in the OCS escrow assumptions. The Administration also assumes that most of the cases will be decided in 1988 and 1989, but on terms much more favorable to the federal government. The government would receive about 96 percent of the funds in dispute in the Administration's estimate.

Aside from escrow releases, CBO and the Administration differ less sharply on their estimated bonuses, rents, and royalties. CBO bases its 1987 estimate of bonuses on the proposed five-year schedule that was announced after the release of the President's budget, which includes three sales in 1987. CBO's outyear estimates are somewhat higher than the 1987 level (due to the unusually small number of sales in 1987). The Administration assumes six lease sales in 1987 and projects outyear receipts on a sale-by-sale basis. CBO assumes lower royalties than the Administration, based on less optimistic oil and gas production assumptions.

Naval Petroleum Reserves and Power Marketing Administrations (Subfunction 954)

The Administration proposes to sell a variety of government assets, including the Naval Petroleum Reserves (NPR) and the Power Marketing Administrations (PMAs), to the public. CBO's estimates of the timing and likely proceeds of these sales differ from the Administration's.

The Administration proposes to sell two oil fields--Elk Hills and Teapot Dome--to the private sector. The Administration projects total offsetting receipts of $3.6 billion over the fiscal years 1987 and 1988. In the light of previous experience with sales of government assets, CBO expects that the sale will not be completed until 1988. CBO estimates total proceeds of $2.4 billion, all of them in fiscal year 1988. The principal reason for the difference in estimates is the expected timing, because in the interim the fields continue to lose some of their proven reserves. CBO also bases its estimates on oil prices that are $3 to $4 per barrel lower than the Administration's. Income from the sale of the Naval Petroleum Reserves would be partly offset by reduced receipts in function 270, because the government would no longer generate receipts from the sale of NPR oil.

The Administration also proposes to sell the five power marketing administrations--Bonneville, Western Area, Southeastern, Southwestern, and Alaska--to the public. The Administration expects proceeds to total about $14 billion over the 1988-1991 period. CBO assumes that Bonneville will be sold as a single entity and that the government will receive full payment in the year of sale. (CBO assumes that all receipts from the sale of Bonneville occur in 1989.) CBO also estimates a lower sales price than does the Administration for Bonneville, but a slightly higher price for other PMA assets. CBO's reestimates of the sale of PMAs total $1.6 billion over the 1988-1991 period. The sale proceeds are partially offset by lower receipts in function 270.

Other Technical Reestimates

All other technical reestimates total $1.1 billion in 1987 and $6.7 billion over the 1987-1991 period. They are described in Table C-7.

CBO's reestimates of outlays for international affairs (function 150) result in lower outlays in 1987, primarily because the foreign military credit program spends much more slowly than assumed by the Administration. This reestimate lowers outlays by $2.1 billion in 1987 and by $6.0 billion over the 1987-1991 period. Partly offsetting this reestimate is CBO's higher estimate of interest subsidies in the Eximbank program, which CBO treats as direct loans rather than as loan guarantees. The Eximbank reestimate adds $0.3 billion in 1987 and $3.2 billion in 1987-1991.

Technical reestimates for science, space, and technology (function 250) are attributable primarily to different spendout rates assumed by the Administration and CBO. The technical differences are largest in 1990 and 1991, and are related to spending for the proposed space station.

Reestimates for energy programs (function 270) make these projections consistent with the timing of asset sales in function 950. The government would continue to earn income from continued production until the Naval Petroleum Reserves and Power Marketing Administrations are actually sold. Remaining reestimates are attributable primarily to different spendout rates.

Spendout rates also account for the bulk of reestimates in the natural resources and environment function (function 300). CBO also projects higher spending for construction grants and Superfund, partially offset by greater timber receipts in all years except 1986.

The largest reestimates in the commerce and housing credit area (function 370) are for the Postal Service, the Federal Deposit Insurance Corporation (FDIC), and the Federal Savings & Loan Insurance Corporation (FSLIC). CBO projects lower net income for the Postal Service in 1987 and 1988, raising outlays by $1 billion and $300 million, respectively. After 1988, CBO assumes increases in postage rates sufficient to pay for additional retirement and health contributions proposed in the President's budget. The required increase is higher than estimated by the President, because the Administration did not reflect the cost of higher health contributions. CBO assumes that the FSLIC will incur higher outlays to assist troubled thrift institutions than projected by the Administration; these are partly offset by higher projected income for the FDIC.

CBO estimates more defaults under the federal ship financing fund than does the Administration, accounting for the largest technical reestimate in the transportation function (function 400). Other technical reestimates stem primarily from different spendout rates. Different spendout and disbursement rates also account for most of the technical reestimates in

TABLE C-7. OTHER CBO TECHNICAL REESTIMATES, BY FUNCTION
(In billions of dollars)

Function		1986	1987	1988	1989	1990	1991
150	International Affairs	a/	-2.1	-0.8	-0.4	-0.1	-0.3
250	General Science, Space, and Technology	a/	-0.1	0.2	0.1	0.5	0.3
270	Energy	-0.2	0.4	-0.4	-0.5	-0.4	-0.8
300	Natural Resources and Environment	-0.3	a/	0.1	0.1	-0.2	-0.3
370	Commerce and Housing Credit	a/	1.8	0.5	-0.6	a/	-0.1
400	Transportation	0.2	0.1	0.2	0.6	0.5	0.7
450	Community and Regional Development	-0.1	-0.3	a/	-0.1	-0.7	-0.3
500	Education, Training, Employment, and Social Services	-0.1	a/	-0.1	-0.8	-0.6	-0.5
550	Health	-0.2	a/	a/	a/	a/	a/
570	Medicare	-0.3	0.4	1.2	2.0	2.6	3.6
600	Income Security	-0.2	0.9	0.2	0.1	0.4	0.6
650	Social Security	-0.5	-0.1	0.3	0.2	-0.7	-0.9
700	Veterans' Benefits and Services	0.1	0.1	-0.1	-0.2	-0.5	-0.5
750	Administration of Justice	a/	0.1	0.2	0.2	0.2	0.2
800	General Government	a/	0.1	0.7	0.3	0.5	0.4
850	General Purpose Fiscal Assistance	-0.3	a/	a/	a/	a/	0.1
920	Allowances	a/	a/	a/	a/	a/	-0.1
950	Undistributed Offsetting Receipts b/	a/	a/	-0.3	-0.4	-0.4	-0.2
	Total	-1.9	1.1	1.8	0.7	1.0	2.0

SOURCE: Congressional Budget Office.

a. Less than $50 million.

b. Excluding OCS receipts, sale of Naval Petroleum Reserves, and sale of Power Marketing Administrations.

community and regional development (function 450), along with different timing and proceeds in the sales of Small Business Administration disaster loans.

The technical reestimates in education, employment, and social services (function 500) are almost entirely in the guaranteed student loan program. CBO assumes lower loan volume and defaults than does the Administration. The technical adjustment peaks in 1989 because the Administration includes a large, unexplained adjustment to outlays in that year to capture program interaction effects. This unexplained adjustment leads to an odd pattern of annual savings from the Administration's legislative program. CBO estimates do not include such a large adjustment.

Technical reestimates for Medicare (function 570) reflect different CBO assumptions about case mix and utilization of medical services. The Administration projects program growth resulting from case mix changes of 1 percent in 1988 and 0.5 percent thereafter. CBO projects case mix increases of 1.5 percent from 1988 through 1991. While case mix increases are an especially difficult component of hospital insurance spending to project, the CBO assumptions are more consistent with recent program trends.

The largest technical reestimate for income security programs (function 600) is for the Aid to Families with Dependent Children (AFDC) program. Technical reestimates to AFDC total $1.3 billion in 1987. Of this amount, $0.8 billion results because CBO assumes that no fiscal sanctions imposed on the states for erroneous payments will be collected in 1987. States intend to litigate the sanctions, resulting in several years' delay in their collection. CBO assumes that only about one-half to two-thirds of sanctions will be collected following waivers and court action, whereas the Administration assumes a 100 percent collection rate. In addition, CBO estimates a higher annual growth in average benefits--about 3.5 percent--that is more in line with historical experience, and estimates lower savings from legislative proposals in the President's budget (primarily the proposal to strengthen work requirements). The technical reestimate of AFDC declines from $1.3 billion in 1987 to $0.9 billion in 1991. Technical reestimates of other programs in function 600 are smaller, generally reflecting different assumptions about numbers of beneficiaries and average benefits.

CBO technical reestimates of Social Security (function 650) reflect a higher assumed rate of growth in the disabled worker population in all years. In the later years, this is more than offset by a lower projection of the retired worker population.

The relatively small technical reestimates for veterans' programs (function 700) in 1986 through 1988 reflect offsetting technical reestimates of a number of accounts. Veterans' compensation and pensions are reestimated downward in all years, reflecting declining caseloads and declines in real average benefits. CBO assumes lower spendout rates for the construction program. Partly offsetting these downward reestimates are higher assumed defaults for the loan guaranty revolving fund. Downward reestimates dominate after 1988.

Higher spendout rates account for most of the reestimates in administration of justice (function 750). Technical reestimates in general government (function 800) are dominated by less optimistic projections of sales of surplus properties. The Administration assumes a reinvigorated effort to identify and dispose of surplus properties; CBO assumes that most sales will be of properties already in inventory.

Technical reestimates in allowances (function 920) are small. Most technical reestimates for undistributed offsetting receipts (function 950) are described above, in the discussions of Outer Continental Shelf receipts and sales of the government's Naval Petroleum Reserve and Power Marketing Administrations. The remaining reestimates are for the employer share of employee retirement, and result from slightly different assumptions about the composition of the covered payroll.

APPENDIX D

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Computer support for the spending analysis in this report was provided by David Bashore, Marion Curry, Kenneth Farris, Vernon Hammett, Vera Powell, David Sanders, and Paula Williams. Other technical support was provided by Janet Airis, George Arnold, Priscilla Aycock, Edward Blau, Betty Embrey, Glen Goodnow, Andrew F. Haughwout, Richard A. Krop, and Robert Sempsey. C.G. Nuckols, Jr. also gave valuable assistance in reviewing the many drafts of the spending chapters.